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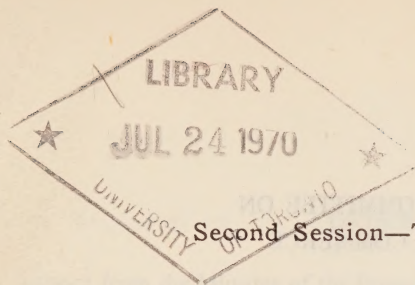
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Canada. Parliament. Senate. Study. Committee
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Second Session—Twenty-eighth Parliament

1969-70

THE SENATE OF CANADA PROCEEDINGS

OF THE
STANDING SENATE COMMITTEE
ON

BANKING, TRADE AND COMMERCE

The Honourable SALTER A. HAYDEN, *Chairman*

No. 30

THURSDAY, JUNE 4th, 1970

*Twenty-Fourth Proceedings on the Government White Paper,
entitled:*

"PROPOSALS FOR TAX REFORM"

WITNESSES:

(For list of witnesses see Minutes of Proceedings—Page 30:5)

APPENDICES:

- "A"—Brief from the Canadian Pulp and Paper Association.
- "B"—Analysis of Appendix "A" by Senior Advisor.
- "C"—Brief from British Newfoundland Corporation Limited.
- "D"—Analysis of Appendix "C" by Senior Advisor.
- "E"—Brief from The Rio-Tinto Zinc Corporation Limited.
- "F"—Analysis of Appendix "E" by Senior Advisor.
- "G"—Brief from the Electronic Industries Association of Canada.
- "H"—Analysis of Appendix "G" by Senior Advisor.
- "I"—Brief from the Canadian Welfare Council.
- "J"—Analysis of Appendix "I" by Senior Advisor.

THE STANDING SENATE COMMITTEE ON
BANKING, TRADE AND COMMERCE

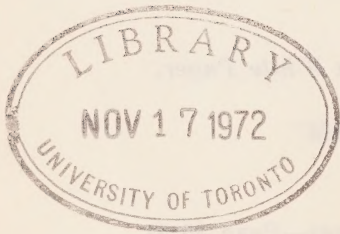
The Honourable Salter A. Hayden, *Chairman*

The Honourable Senators:

Aird	Croll	Isnor
Aseltine	Desruisseaux	Kinley
Beaubien	Everett	Lang
Benidickson	Gélinas	Macnaughton
Blois	Giguère	Molson
Burchill	Grosart	Phillips (<i>Rigaud</i>)
Carter	Haig	Walker
Choquette	Hayden	Welch
Connolly (<i>Ottawa West</i>)	Hays	White
Cook	Hollett	Willis—(30)

Ex officio members: Flynn and Martin

(Quorum 7)



ORDERS OF REFERENCE

Extract from the Minutes of the Proceedings of the Senate, November 19, 1969:

“With leave of the Senate,

The Honourable Senator Martin, P.C., moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on Banking, Trade and Commerce be authorized to examine and report upon the White Paper intituled: “Proposals for Tax Reform”, prepared by the Minister of Finance, and tabled in the Senate on Tuesday, 18th November, 1969.

After debate, and—

The question being put on the motion, it was—
Resolved in the affirmative”

Extract from the Minutes of the Proceedings of the Senate, December 19, 1960:

“With leave of the Senate,

The Honourable Senator Phillips (*Rigaud*), moved, seconded by the Honourable Senator Robichaud, P.C.:

That the Standing Senate Committee on Banking, Trade and Commerce be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—

The question being put on the motion, it was—
Resolved in the affirmative.”

Extract from the Minutes of the Proceedings of the Senate, February 18, 1970:

“With leave of the Senate,

The Honourable Senator McDonald moved, seconded by the Honourable Senator Hayden:

That the Standing Senate Committee on Banking, Trade and Commerce have power to sit during adjournments of the Senate.

After debate, and—

The question being put on the motion, it was—

Resolved in the affirmative.”

ROBERT FORTIER,
Clerk of the Senate.

MINUTES OF PROCEEDINGS

Thursday, June 4th, 1970.
(47)

MORNING SITTING

Pursuant to adjournment and notice the Standing Senate Committee on Banking, Trade and Commerce met this day at 9:00 a.m. to further consider:

The Government White Paper entitled: "Proposals for Tax Reform".

Present: The Honourable Senators Hayden (*Chairman*), Aseltine, Beaubien, Benidickson, Blois, Carter, Cook, Desruisseaux, Everett, Flynn, Gelinas, Haig, Hollett, Isnor, Kinley and Molson—(16).

Present, but not of the Committee: The Honourable Senators Bourget and Method—(2).

In Attendance: Roland B. Breton, Executive Secretary.

WITNESSES:

CANADIAN PULP & PAPER ASSOCIATION.

Executive Board of C.P.P.A.

Mr. A. H. Hamilton, President, Domtar Pulp & Paper Products Limited and Vice-Chairman, Executive Board;

Mr. J. G. Prentice, President, Canadian Forest Products Ltd.;

Mr. A. H. Zimmerman, President, Northwood Pulp Limited.

C.P.P.A.

Mr. R. M. Fowler, President;

Mr. H. Hart, Vice-President;

Dr. D. A. Wilson, Economist;

Mr. C. Brooke, Domtar Pulp & Paper Co.;

Mr. G. Gibb, Canadian International Paper Co.;

Mr. E. Rankin, Anglo Canadian Pulp & Paper Co.;

Mr. F. Huck, Treasurer, Bowaters Corp.

BRITISH NEWFOUNDLAND CORPORATION LIMITED

RIO TINTO-ZINC CORPORATION LIMITED.

Mr. W. Mulholland, President and Chief Executive Officer, British Newfoundland Corporation;

*The Honourable Senator Everett *Acting Chairman* in the Chair.

Mr. H. W. MacDonell, Vice President, British Newfoundland Corporation and Churchill Falls (Labrador) Corp. Ltd.;

Mr. R. C. Berry, Vice President and Chief Financial Officer, British Newfoundland Corporation;

Mr. J. C. Wilson, partner, Peat, Marwick, Mitchell & Company, Auditors;

Mr. P. Lawlor, Taxation Manager, Rio Tinto-Zinc Corporation Ltd.;

Mr. P. A. T. Keeping, Vice-President, Churchill Falls (Labrador) Corp.

At 12:30 p.m. the Committee adjourned.

AFTERNOON SITTING

2:15 p.m.
(48)

At 2:15 p.m. the Committee *resumed*.

Present: The Honourable Senators Aseltine, Beaubien, Benidickson, Blois, Carter, Cook, Everett, Haig, Hollett, Isnor, Kinley, Molson and Willis—(13)

In attendance: Alan J. Irving, Legal Advisor.

WITNESSES:

ELECTRONIC INDUSTRIES ASSOCIATION.

Mr. R. Longstaffe, Executive Vice-President, Renfrew Electric Company and Vice-Chairman of Electronic Ind. Assoc.;

Hon. L. Balcer, President;

Mr. D. Sheperd, President; Corning Glass Canada Ltd.;

Mr. A. D. McAlpine, Q.C., Counsel.

CANADIAN WELFARE COUNCIL.

Mr. H. S. Racine, Chairman, Executive Committee;

Mr. R. C. Baetz, Executive Director;

Mr. R. E. G. Davis, Taxation Committee;

Mr. B. Philip, Chartered Accountant;

Mr. M. Wheeler, Director of Research;

Miss P. Godfrey, Executive Secretary.

Ordered: That the documents submitted at the meeting today be printed as appendices to these proceedings, as follows:

A — Brief from the Canadian Pulp and Paper Association.

B — Analysis of Appendix "A" by Senior Advisor.

C — Brief from British Newfoundland Corporation Limited.

D — Analysis of Appendix "C" by Senior Advisor.

- E – Brief from The Rio-Tinto Zinc Corporation Limited.
- F – Analysis of Appendix “E” by Senior Advisor.
- G – Brief from the Electronic Industries Association of Canada.
- H – Analysis of Appendix “G” by Senior Advisor.
- I – Brief from the Canadian Welfare Council.
- J – Analysis of Appendix “I” by Senior Advisor.

At 5:00 p.m. the Committee adjourned to the call of the Chairman.

ATTEST:

Frank A. Jackson,
Clerk of the Committee.

NOTE: Issues Nos. 27 and 28 will follow—delayed, due to technical difficulties in printing.

THE STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE

EVIDENCE

Thursday, June 4, 1970

The Standing Senate Committee on Banking, Trade and Commerce, met this day at 9 a.m. to give further consideration to the White Paper entitled "Proposals for Tax Reform".

Senator Salter A. Hayden (*Chairman*) in the Chair.

The Chairman: Honourable senators, we have a full list of submissions to hear today and we shall start off by considering that of the Canadian Pulp and Paper Association. Mr. Hamilton will make an opening statement and will introduce his panel. Will you please proceed, Mr. Hamilton?

Mr. A. H. Hamilton, (President, Domtar Pulp and Paper Products Limited), Canadian Pulp & Paper Association: Mr. Chairman, I am taking the place of Mr. I. H. Peck, the Chairman of the Executive Board of the Canadian Pulp and Paper Association. He has asked me to express his regrets to you and your committee, and explain that he is rather deeply involved in labour negotiations in Montreal, and felt that he should stay there. He has asked me to take his place.

Associating themselves with the presentation of this brief today are representatives of the Canadian Pulp and Paper Association and the industry. From the Canadian Pulp and Paper Association we have our President, Mr. R. M. Fowler, who is on my right, and Mr. D. A. Wilson, who is the fourth down from me.

Representing the industry is Mr. John Prentice President of Canadian Forest Products Ltd. of British Columbia; Mr. Adam Zimmerman, the President of Northwood Pulp Limited which is also located out in British Columbia.

We have with us some advisers, namely, Mr. Graham Gibb from C.I.P. Company; Mr. Frank Huck from Bowaters; Mr. Ewin Rankin from Anglo Canadian; and Mr. Colin Brooke from Domtar.

With your permission, Mr. Chairman, I will ask Mr. R. M. Fowler to make an opening review of the situation as we see it.

The Chairman: Very well.

Mr. R. M. Fowler, President, Canadian Pulp and Paper Association: Mr. Chairman and honourable senators, I think you have had the brief in your hands for some weeks, and I do not propose to go through it in detail. I would like to give you a background summary of some of the highlights, and leave other points to be raised by the questions later on.

Perhaps I should say just a word about the background of the pulp and paper industry. We are here representing one of Canada's largest industries, 80 per cent of the products of which are exported. Last year the total production of all products was 18.5 million tons, of which 15 million tons, with a value of about \$2 billion, were exported. The prices for virtually all of our production are set in world markets.

The industry's future well being and growth are dependent upon its maintaining its competitive strength against international competition, and in this competitive struggle one of the major determinants is taxes—taxes that affect its costs, and taxes that affect the attractiveness of this industry and of Canada as a place for new investment. We are, therefore, greatly concerned about Canadian tax policy, and we will be greatly affected by the decisions taken on the proposals in the White Paper.

At the present moment we believe that the Canadian pulp and paper industry appears to be poised for a major expansion. It has today, and over the next five or ten years, the opportunity of growing quite rapidly to meet rising world demands for wood fibre. We now have a good deal more knowledge of world trends in supply and demand than we used to have. There are FAO statistics on these commodities, which have proved in the past to be remarkably accurate. They show a total consumption in 1968 of 112 million

metric tons of all products of paper and paperboard. This is forecast by the FAO to rise to 163 million metric tons in 1975 and 205 million metric tons by 1980. So there is nearly a doubling of the total world demand for these products in the space of 10 to 12 years.

We also know that major consuming areas, notably western Europe and Japan, have reached the limit of their domestic forest resources. Their growing demands for wood fibre in varying forms will have to be met increasingly by imports. So there is likely to be a major shift for sources of supply of wood fibre for large consuming markets.

We in Canada still have some vast reserves of wood in forest resources that are being fully utilized. It was estimated a few years ago that we could easily expand our production by doubling it and with more intensive forest management could probably triple it.

If the shift in world demand does swing to Canada, our pulp and paper industry could grow at a quite rapid rate, more rapid than that based on the traditional expansion of markets.

However, pulp and paper technology have also made advances in recent years. The northern softwood species no longer have the monopoly for making pulp and paper. There are unutilized resources in the United States and vast areas of tropical woods, which are quite usable, in Africa, South America and the Far East. These are practically untouched today.

In addition, forestry techniques have developed to the point where it is possible to make man-made forests. In the course of a relatively short time, because these are fast growing species, you can set up other sources of supply. So the swing of demand does not have to come to Canada. It can easily go elsewhere and the choice will depend on the relative economic attractiveness in different countries. For that, tax policy is the major determinant.

We have in Canada today a great and almost unique opportunity for major growth of this industry over the next decade. If we miss it and set our economic policies, particularly our tax policies, wrong, the world demand is just not going to wait very long for these answers.

This leads us to a rather fundamental disagreement with the basic approach taken in the White Paper. However many times you read it, you cannot escape the conclusion that it places the emphasis on equity in taxation. This, of course, is a necessary and desirable attribute of any tax system. However, the White Paper

grossly underestimates the importance of economic growth, which itself will produce greatly expanded tax revenues for all levels of government.

No one argues for a moment that a tax system should not be equitable, just as equitable as it can be made. It should be constantly reviewed and changed to prevent abuses, eliminate evasions and reduce inequitable burdens on one or other individuals or groups. This process of amendment and improvement has been going on in fact for a long, long time.

We approve and support certain proposals in this direction in the White Paper. However, the underlying philosophy of the White Paper goes far beyond the correction of abuses and the adjustment of inequities between individuals and groups. It proposes an increase in taxes and the share of total national production taken by governments.

It is essentially a negative and static approach to tax reform. The White Paper sets fairness of the tax system as a primary objective and then goes on to hope that this will not seriously interfere with economic growth, productivity and personal incentive.

We argue that tax policy should be positive and dynamic. If tax policy is deliberately aimed at stimulating growth and investment by increasing personal and corporate incentives, it will expand the GNP. Under such a tax structure government revenues will rapidly expand to make up any losses from tax reductions and provide adequate revenues for necessary public expenditures, thus approaching tax reform from an entirely different angle to that taken in the White Paper. That is, we suggest, a more appropriate stance for a young, vigorous, still developing country to take.

The White Paper's approach might be suitable for a mature, static economy. However, we suggest it makes no sense for Canada today.

Thus we are not basing our arguments mainly on the damage that will be done by the Government's proposals, although that damage is likely to be considerable.

These proposals will result in less domestic saving, less foreign investment and greater difficulty in attracting and holding the productive younger people. They will greatly increase administration and compliance costs and slow economic growth.

However, our essential argument is that the present tax system is not making its full contribution to economic growth. Rather, by excessive burdens in

relation to the tax system of other countries, it is reducing personal incentives and inhibiting growth.

If we are going to reform our tax system we should correct the flaws that exist in the present one and use this opportunity to achieve a tax system that will stimulate economic performance closer to our potential.

The White Paper is called "Proposals for Tax Reform". One of the definitions of reform in the Oxford Dictionary is a change for the better. We think the paper is mistitled.

Our proposals for an alternative approach to tax reform are summarized in the second and third pages of the introduction to the brief.

Mr. Chairman, in a very over-simplified form I would like to list them.

First, we say start with the concept that tax policy should be deliberately set to stimulate economic growth and development, to increase individual initiative and investment. If this is done, the tax base will be widened and revenues of governments at all levels will be increased. In the process greater equity within the system can be more easily and effectively attained.

Equity and economic growth are not alternatives. In fact, if you achieve good economic growth you will have more chance, more elbow room to establish equity.

Secondly, reduce, as proposed in the White Paper, the tax burden on the low income earners and progressively reduce the top marginal rate to 50 per cent, to increase personal incentives.

Third, refrain from increasing the marginal rates on middle income groups. They are also too high and they weaken incentives for the younger, more productive and mobile people whom we need to attract and retain.

We have examples of the disparities that exist between Canada and the United States. However, I am sure your committee has already heard this.

The fourth step is to reduce progressively the level of corporation rates to improve the competitive position of Canadian industries in world markets and to attract needed capital for further growth.

The pulp and paper industry may be a good type of case for you to consider. The level of corporation taxes in Canada is at least five percentage points higher than

that for our competitors in the United States. This point is outlined in the brief. That difference has a strong influence on investment decisions. We urge that the Canadian rate should be reduced in stages to a level that is no higher and preferably would be somewhat lower than that of the United States.

We also urge that there should be full integration of personal and corporate income taxes, treating widely-held and closely-held corporations in the same way.

We consider the distinction proposed in the White Paper to be simply unworkable. It would produce some startling inequities, of which we can give specific examples if you wish.

In this we strongly urge that the integration should be carried out by way of a dividend tax credit system, rather than by the complicated system proposed in the White Paper.

Fifth, despite its general popular appeal at the moment, we oppose the introduction of a capital gains tax at this time. The fact that we do not have such a tax today is an advantageous feature in our present system, and this advantage should not be thrown away. We believe that such a tax, after the costs of administration and compliance with a complicated system are taken into account, will yield relatively little. This is simply a game that is not worth the candle.

We argue that we should retain the positive advantages of not having a capital gains tax, and any remaining abuses in the present system can be eliminated, as they have been progressively in recent years. To introduce a tax now will undoubtedly have an adverse effect on Canada's growth and development. However, if for social or political reasons we must have a capital gains tax, then we suggest it should be a simple form of tax, no more onerous or complicated, and preferably less so, than similar taxes in other countries. This is all developed on pages 14 to 18 of the brief.

We do propose that this package that we suggest should be adopted as a declared policy now, and progressively implemented over, say, a five-year period. It is not possible even for a large industry such as ours to make a precise estimate or to construct an accurate model for the future, but we have tried at page 9 of the brief to estimate the order of magnitude of the changes we propose.

If these proposals were introduced in one step it would produce a net reduction from the yield of the system proposed in the White Paper to slightly over \$1½ billion to federal and provincial governments

combined. It is fair to ask how this drop in revenue can be made up. Well, there is a small offset, a partial offset, in the fact that we have a \$300 million to \$350 million surplus at the moment, which is probably necessary for purposes of fighting inflation, but it may not have to be carried on for ever. But the main offset will come in another way. It will come from the increased tax yields at a higher level of economic activity. Our proposals would be a powerful stimulus to growth, and as the GNP goes up because of the progressive nature of our tax system government revenues go up even more rapidly.

We have had in the 'sixties in Canada an average annual growth rate in real terms of nearly 5 per cent. This has been slightly lower than the growth in most other developed countries. It would be reasonable to expect that the effect of the restrictive features in the White Paper on Canada's growth rate would be to reduce it to at least 4½ per cent, perhaps lower. It is also reasonable to think that positive stimulation of growth along the lines of our proposals would raise our growth rate from 5 to 6 per cent. The difference of 1½ percentage points, if applied to just 1969 gross national product of \$78 billion, would result in an increase of \$6½ billion in GNP in the fifth year. As governments now take about a quarter or more of GNP in taxes—just in taxes I am talking about now—the increased yield from such an improvement in GNP would be at least \$1½ billion, which is quite enough to more than balance the books.

Since preparing this brief, Mr. Chairman, we have done some work in an attempt to refine our proposals and show how they work out year by year if staged over a five-year period. We had to make certain assumptions as to the timing of tax changes designed to stimulate growth, and we believe these assumptions are reasonable ones. Obviously, however, if you change the assumptions or the timing of the changes, then the detailed results will be altered also. With your permission, Mr. Chairman, we would like later to file these detailed estimates, when they have been checked in a few days time. However, I would like to give you the indications of how they seem to work out.

First, if we go on with our present tax system and our current annual rate of growth, GNP will rise in constant dollars from about \$78 billion in 1969 to about \$98 billion in 1974. Under the White Paper's proposals, at a slightly lower average growth rate, the GNP in 1974 will be about \$1 billion less, around \$97 billion. If our tax proposals, along with other appropriate policies, should succeed in raising the annual growth rate to 6 per cent, the 1974 GNP will approach \$104 billion in constant dollars.

Secondly, if the tax reductions are staged as we suggest, the resultant total government revenues in each year will under our proposals be maintained at close to the yields under our present tax system, but would not produce the substantial and increasing government revenues projected in the White Paper. The differences between the present system's yield and the proposed system as we calculate it appear to be relatively small, and quite manageable within the kinds of pluses and minuses we have been familiar with.

Thirdly, by reducing taxes and stimulating growth, our proposals will, we believe, avoid the substantial increase in the proportion of GNP taken by governments as proposed in the White Paper. Instead, they would produce a slight reduction in the proportion of total GNP taken by government. Under the White Paper the percentage of total production going into public hands will rise from slightly under 32 per cent in 1969 and 1970 to over 35 per cent in 1974. They will remain substantially constant under the existing tax system, but we believe that our proposals would result in a slight decline in the percentage taken by governments from about 32 per cent today to below 31 per cent in 1974. We believe this is a desirable direction for tax reform to take.

Obviously, Mr. Chairman, we have not the facilities to construct a complete working model of the suggested alternative system, or predict precisely how it will work out, so when we submit our detailed calculations we would hope your committee will be able to scrutinize the assumptions we have made and check the resultant calculations. At best it is an indication of an alternative approach to tax reform as put forward in the White Paper.

Admittedly, the adoption of the more dynamic approach to tax reform involves risk. You cannot be sure that some world forces or developments will not occur that will interfere with the result we expect. You may not get 6 per cent and have to settle for a somewhat lower figure. But, heavens above, risk is what a young and growing country like Canada should take, and sometimes you create order by taking risks.

Thank you, Mr. Chairman.

The Chairman: Are you ready for questions?

Mr. Hamilton: Yes, sir.

Mr. Fowler: As much as we ever will be.

The Chairman: I notice in your comment on integration you express a preference for the dividend tax credit system. When I look at your brief, at page 11 you state generally:

We support full integration of corporate and personal income taxes.

Is there some distinction you are drawing in the use of the word "full" qualifying integration?

Mr. Fowler: No. That is merely full as not to distinguish between widely held and closely held corporations. If you turn to page 12, in the middle of the page you will see why we favour the principle of integration. There are serious practical disadvantages to the White Paper proposals. This will greatly complicate administering the system. We talk about the dividend tax credit system as being a more appropriate method.

The Chairman: What bothers me is the apparent two parallel lines along which you are proceeding. I am putting down integration and dividend tax credit. You say that the integration as proposed in the White Paper is not workable or desirable. You use the language that it has serious practical disadvantages. I would be more interested in knowing what the serious practical disadvantages are than in your approval of the full integration system.

Mr. Fowler: May I call on Mr. Brooke to answer that. He is a serious practical fellow.

Mr. C. Brooke, (Domtar Pulp & Paper Products Limited), Canadian Pulp & Paper Association: Mr. Chairman, the problems that arise in the integration proposal are in two or three parts. First of all, the amount of bookkeeping involved in sorting out exactly what creditable tax is becomes significant. You create a conflict between management and shareholders. What is good for the company is not necessarily creating creditable tax for the shareholders. You also create conflict between various classes of shareholders, particularly when you have the five-year revaluation proposal where it is in the interest of some groups to have stock dividends and not in the interests of others to have a prepaying tax, whereas others are getting benefits. You create distinctions in your investment policy as to what is good and what is bad, which distinctions are unrealistic for Canada. It makes investments in the hot dog stand in Canada preferable to the converting plant in the United States. I think those are the principal ones.

The Chairman: Let us take deemed realization. Do you support that?

Mr. Brooke: No.

The Chairman: We will eliminate that from the column that supports the White Paper integration. Do you support the two-and-a-half-year limit on creditable tax.

Mr. Brooke: No.

The Chairman: That is another part of the column which we will take out. Do you support the categories of widely held corporations and closely held corporations?

Mr. Brooke: No, we think that is an artificial distinction. I think there is perhaps a valid distinction between the partnership companies and other companies, but not between widely held corporations.

The Chairman: Do you support the obvious omission to recognize small business as being in a separate category and not part of the integration proposal?

Mr. Brooke: I think that is a different category of problem. It is not one which our association is particularly concerned with. We have no solution to that particular problem.

The Chairman: I was not asking you for a solution at the moment. Do you think that the small business problem should be interjected and a solution found in a grouping of closely held corporations under the White Paper or whether it should be considered apart?

Mr. Brooke: I think it should be considered apart.

The Chairman: We have advanced our work of demolition quite a bit, have we not, on the integration proposals in the White Paper?

Mr. Brooke: Yes.

The Chairman: Can you give me any estimate as to whether the figure in the tables in the White Paper indicate a minus position as a result of implementing the integration policy of about \$235 million? Would that become a greater minus problem or would it add some pluses to that figure by what we have done in our demolition?

Mr. Brooke: I do not think I could give a good answer to that question. There is so much greater

flexibility in adjusting that you can end up with almost any figure you set out to achieve.

One of the propositions we are making is to have a spread over a five-year period. You could adjust those figures by different tax credits and tax changes to whatever is required.

The Chairman: In regard to the integration proposals, we have been told by what you might call multinational companies, who appeared before us, that it would work very much against their position in world markets.

Mr. Brooke: Correct.

The Chairman: Do you agree with that?

Mr. Brooke: Yes.

Mr. Hamilton: Would you care to add to Mr. Brooke's comments, Mr. Huck?

Mr. F. Huck, (Treasurer, Bowaters Canadian Corporation), Canadian Pulp & Paper Association: Mr. Chairman, I am treasurer of Bowaters Canadian Corporation, which is the holding company for various Bowaters companies in Canada and which, in turn, is owned by the Bowater Paper Corporation, an international company with its headquarters in London, England. We are most concerned about the White Paper proposals in regard to the tax on dividend flow-through. I will try to give you an example, which concerns us. Bowaters-Mersey Paper Company of Nova Scotia is a widely-held company which has preference shares quoted on the Canadian Stock Exchange. Its parent, Bowaters, is a Canadian corporation which is a closely held company and its parent, as I mentioned before, is Bowaters Paper Corporation in London, which is widely held. It also has shares quoted on the Canadian Exchange.

Take \$100 of earnings arising in the subsidiary, Bowaters-Mersey, and assume the tax rate is 50 per cent—\$50 less. This amount is paid as a dividend to the parent, and another bite, after giving creditable tax, of \$12.50 is taken off. Out of \$37.50 left, it is remitted to England, and another 15 per cent is taken off. Altogether, 68 per cent would be taken off if the proposals of the White Paper were carried out. Then, for any Canadian who is lucky enough to hold Bowaters stock in Canada it is clipped on the way back. What is left in the shareholder's pocket is practically nothing, with no creditable tax.

The Chairman: What would happen under the present system?

Mr. Huck: There would be no tax on dividend flow-through from the subsidiary to the parent in Canada. There would be a withholding tax from Canada to England.

The Chairman: On the return trip?

Mr. Huck: On the return trip they would still take their pound of flesh. Under the White Paper there is an extra 12 1/2 per cent levy which is very high.

Mr. J. G. Prentice, (President, Canadian Forest Products Ltd.) Canadian Pulp & Paper Association: Could I be permitted to make a remark? Canadian Forest Products is a closely held corporation, and within our association there was no unanimity on the subject of closely held versus widely held companies. I would say that I have no objection at all to the idea that they should be treated the same, assuming that the whole of the proposals of the association brief would be legislated. Assuming only part of them would be legislated, I believe it would be valuable to retain some of the features of the proposed legislation as they apply to closely held corporation.

The Chairman: The question arises whether the White Paper integration, when you eliminate some of the features we have been talking about, is a workable thing and in that reduced form whether it has real value. Do you think the treatment of closely-held corporations under the integration proposal is helpful to closely-held corporations?

Mr. Prentice: Yes.

The Chairman: Well, I suppose everything is relative. One of the great disadvantages would appear to be that which is well illustrated by Simpson's and Eaton's. Would you not look at the place where they meet to do business, the competitive positions of people who are closely-held and people who are widely-held under the White Paper and whether, in the light of that, you can justify the differences in treatment under the White Paper?

Mr. Hamilton: I think this is where the Canadian Pulp and Paper Association perhaps comes apart. Mr. Prentice mentioned that we did not have a consolidated view, a unanimous view, with regard to this question on proposals with regard to the closely-held and widely-held corporations.

Senator Everett: What the chairman is asking is whether there is a difference in terms between Simpson's and Eaton's. One is a privately held company and the other is a company which is listed on the stock exchange. Taking that into account, would you like to state whether or not you think there is a difference when you are dealing with the concept of integration under the White Paper?

Mr. Prentice: I do not believe that I could properly answer that question. I can see that there is a case to be made for equal treatment but I would hope that when the final legislation comes down that it does not eliminate some of the advantages. I was thinking primarily of the five-year feature, the five-year revaluation feature.

Senator Everett: Were you not thinking of the situation of a closely-held corporation whose surpluses tended to be locked in in a certain form under the present laws? Were you not saying that in your judgment the integration proposals tend to secure that?

Mr. Prentice: Yes.

Senator Molson: What would you say is the disadvantage of the closely-held corporation today under the existing taxes, Mr. Prentice? Are there any specific problems in relation to widely-held corporations?

Mr. Prentice: There are serious sorts of imbalance. The legislation has something to offer to the closely-held corporations. Our policy has been one of building up the country. I felt that it would be easier to achieve this under the proposed rules than if the capital gains features would be applied every five years. This is what I had mostly in mind.

Senator Molson: If you eliminate that, your position would change, then?

Mr. Prentice: Yes.

Senator Beaubien: I would like to ask Mr. Fowler a question on integration of the personal income tax. Mr. Fowler, do you suggest that if we had integration in terms—I do not mean applied in the same way, but such integration as we had in the White Paper, where the man who has a low income bracket pays no tax on his dividend but receives a cheque from the Government? Are you suggesting that system of integration of personal income tax?

Mr. Fowler: I would like the experts to answer that.

Senator Beaubien: One of our studies shows that the man who has got \$20,000 from dividends and has no other income pays no tax and receives a cheque from the Government of \$1,100 a year. He pays no tax at all and gets \$1,100 a year. The only way we could see that the department could ever hope to do without that amount of revenue would be to have the five-year revaluation, to get it back on capital gains tax. Otherwise, how could it be possible to continue on getting no tax but also pay out the \$1,100. How do you propose to get over that, or do you still want to integrate it?

Mr. Brooke: I think that does present a problem. The dividend tax credit on the full rate would perhaps not be worth it. A dividend tax credit at the present rate of 20 per cent does give an abatement of tax on other earnings, to a limited extent, to the low income people right now.

Senator Everett: On page 14 of your brief, you say:

To provide for fair taxation of income earned through corporations we recommend full offset by means of a dividend tax credit.

Mr. Brooke: I think there are problems on full integration. One would like to have the full offset by means of a dividend tax credit, but I think there are problems.

Senator Everett: Let us talk about integration. Let us define our terms. Are we agreed that integration is that process which exists under the White Paper?

Mr. Brooke: Yes.

Senator Everett: And that tax credits is what you are proposing. The question then arises, are you saying that tax credits should be such that there is no additional tax paid on distribution of a corporate surplus, corporate earnings?

Mr. Brooke: That there is as little additional tax as possible paid.

Mr. Hamilton: I think we approached this from the standpoint of accepting the thought that it was desirable to make it more easy for Canadian investors to invest in Canadian companies, that this was the desirable objective, to encourage participation in equities of Canadian companies. We thought that the dividend tax credit was a more easily administered

route than the type of proposal that was introduced in the White Paper, which you call "integration". That was about our view.

Senator Beaubien: You mean that what you suggest is to continue what we have now?

Mr. Hamilton: That is right. It could be adjusted, if necessary. It could be made more complex to cover a wider range of special situations, if necessary. But we think there is some virtue in its simplicity, that it is understood by investors. We question whether the aim of participation by the average fellow in the street in Canadian equities, if this is supposed to be a good objective, that he could possibly comprehend the complexities of the system that is proposed under the White Paper.

Senator Beaubien: It is not easy.

Mr. Hamilton: It is not easy, no.

Senator Everett: What do you mean by full offset by means of a dividend tax credit? We might be able to agree on philosophy but we would like to know how you propose to operate it?

Mr. Hamilton: I do not think that we are in a position at this point in time to get into the discussion of exactly how far we think the system should be developed. We are buying the concept because of the integration proposals in the White Paper, that there was full integration. I think we picked that phrase "full offset" and applied it in the case of the dividend tax credit.

Senator Everett: We have the responsibility to make a report. It does create a difficulty.

Mr. Hamilton: That is right.

Senator Everett: When you talk about "full offset," we would like to have some indication how full offset would work? It strikes me that you may be forced back into the same problems that you are concerned about under the White Paper integration systems. Take the case of incentive taxes to any corporation—some help to them under a whole offset.

Mr. Hamilton: Mr. Chairman, we have a working paper here which has been prepared and which purports to set out some of the mechanisms as to how you can acquire various degrees of offset. We will be pleased to file this with you, if it is your wish.

The Chairman: We would certainly like to see it, but there is a question which arises out of what Senator Everett has asked. The criticism in the White Paper, Mr. Hamilton, on the present dividend tax credit system is that people get the benefit of that on dividends received where the corporation itself has paid no tax.

Senator Benidickson: The answer to that is on page 14.

The Chairman: We have had some discussion on this yesterday, and there was a suggestion that the dividend tax credit might be made inapplicable to dividends from companies which have paid no corporate tax. Do you think that is workable? Would you approve of it as a method?

Mr. Hamilton: With the power of government these days, I suppose anything is workable. It comes down to this; what is the objective of the tax credit or the full integration proposals. It is a question of looking at it from the standpoint of the company or the shareholder. The shareholder is investing in the company presumably as an opportunity to participate and he is interested in his tax situation, hence the dividend tax credit as it applies to him. If the corporation is not paying tax, presumably that is because there is good and sufficient reason as far as the Department of National Revenue is concerned, and presumably the shareholder would be taking a look at this when making his investment.

Senator Benidickson: Well, have you not treated this a little differently? I don't know how we got on to this question of the offset of tax credit. That is not the essence of your brief as I read it. The essence of your brief is that you say you approve of integration, but that is not at all necessary as the type of integration that would flow from the acceptance of the proposals in the White Paper. What you are really saying is that you approve of something in the tax system that avoids double taxation where a corporate tax is paid, and then another tax is paid on the income of the shareholder, and you say that the dividend tax credit to date has recognized this in part. It has recognized that complaint about double taxation. But, as I see it, the answer to this question as to whether you can give a dividend tax credit with respect to a company that has not actually paid corporation taxes within the taxing period—you answer that on page 14 where you say that the answer is that over a period of years, there may be years in which tax credit is given and taxes were not paid, but over the long period

there will be other years where you have the reverse situation.

Mr. Fowler: And over the years it balances out.

The Chairman: Senator Benidickson, you put your finger on the spot. There is inherent in the White Paper proposals just that kind of situation. For instance, incentives which are granted to corporations and which may have the effect of reducing their earnings and therefore reducing their taxes or reducing creditable tax, so that something in the way of incentives and which is proposed to be beneficial to the company operates to reduce taxes which is also supposed to be of benefit to the company, but then inherently the shareholder does not get the benefit in the sense of dividends.

Senator Everett: But unfortunately the total offset system creates the same problem.

Mr. A. H. Zimmerman, (President, Northwood Pulp Limited) Canadian Pulp & Paper Association: I think, Mr. Chairman, you could turn the question around a little bit. Under the present rules where you have a 20 per cent dividend tax credit, that applies to the dividends of many companies which effectively are not paying the 20 per cent tax rate now, although under the deferred tax method of accounting, one assumes they have provided for that. I think you can really regulate or legislate any kind of anomaly that you think occurs in this situation, but broadly speaking I think the issue before us is; is it right to assume that each company pays its taxes appropriate to its circumstances, and having done so, then whatever is left over is available as a dividend to the shareholder, who in turn pays his tax according to his circumstances. Now, if you are trying to encourage his ownership of Canadian securities, presumably you are going to give him a higher yield by a lower tax rate. But that is not tax policy; that is economic policy, perhaps. I think the two are becoming confused.

Senator Everett: Mr. Zimmerman, don't you say the opposite of that statement in your brief where you support full integration? You say that the corporation pays tax according to its circumstances and then the shareholder pays tax according to his circumstances, but that does not seem to fall into conformity with the concept outlined on page 8, paragraph 3.

The Chairman: I wonder whether it is a misnomer to call that kind of thing integration at all.

Mr. Fowler: I think perhaps we fell into error in suggesting full integration. I think Senator Benidickson puts the matter more accurately. We would like to avoid double taxation and to do it by way of an extension and an adaptation of the present system is a much simpler way of doing it.

The Chairman: In England when they switched from the integration system in 1965, the theory was that the corporation paid its tax and the shareholder is another entity who has something coming in from dividends as part of his income, and he is subject to tax on that, and never the twain shall meet. Each one is dealt with in his own pocket, and if he is entitled to a concession, he gets it by way of a tax credit.

Mr. Zimmerman: If you wish to look at our present system, the 20 per cent tax credit will help to avoid or eliminate the double taxation, when you look at it in one way, and it is in effect a measure designed to encourage Canadian ownership of securities if you look at it in another way. I am sure the truth is part of both, probably. You can arithmetically make a system where the dividend tax credit does give a complete offset to the tax paid by the company and related to the individual circumstances. Perhaps that is complicated.

The Chairman: I think perhaps we are on safer ground if we take as the base what Senator Benidickson said was the object of this particular provision, that is to avoid as much as possible what is called double taxation.

Mr. Zimmerman: I would also like to add that I think one of the most offensive sections in this is the tax on income flowing between corporations which has already been alluded to. It does have the effect of removing some of the benefits that have flowed through a chain of corporations, and in the end you are paying the full rate of tax and this will simply force a massive corporate reorganization for which we can see no useful purpose.

Senator Everett: Mr. Chairman, I wonder if we could move to another subject, one which is fairly closely related?

The Chairman: Yes, Senator Everett.

Senator Everett: Mr. Fowler, in your verbal statement you said that you could give examples of inequities caused by the division between closely held and widely held corporations. I do not know if you meant by that the Bowater situation.

Mr. Fowler: I did mean that, yes. I meant that as an example. We have not gone through all the other possible changes of corporate structure of many corporations in the industry, but this was one.

Senator Everett: That is the only example?

Mr. Fowler: The only one we really have worked out.

Senator Everett: Mr. Fowler, you make two statements which I would like to bring together. One is that the direct taxes, especially the corporation tax, should not be more rigorous than the tax imposed by Canada's major competitors—specifically, of course, the United States. You also make the statement on page 8, item 5, that:

The value-added tax has been adopted by members of the European Economic Community.

I also understand it is being given consideration by the American administration at this time. You feel that if we did not have such a tax it would seriously affect our export position. You also go on, at the bottom of page 10, to state:

Moreover, should the proposals not meet revenue needs in the first year or two, the sales tax base could be broadened to provide additional revenue.

Would you care to state, Mr. Fowler, whether there is support from yourself and the Association for the proposition that Canadian direct taxes generally should not be more rigorous than American direct taxes?

Mr. Fowler: Yes.

Senator Everett: And if there is a need for additional Canadian revenue, by virtue of the fact that our per capital efficiency is not as great as the American per capital efficiency, that this difference be made up by indirect taxes, with specific concern being given to the value-added tax?

Mr. Fowler: We did not phrase it this way, but I think that is a very accurate answer. There is competition between countries, not only in goods but in tax systems. There are many things going on in the world and we think that for competitive reasons, because of the value-added tax type of development in Europe, because of the DISC proposals in the U.S.—which is another form of dealing with exporting industries—we may be forced into a position in Canada

of having to resort to some such type of tax which, of course, will come into your calculations and alter them. But, generally speaking, we do feel that, for purposes of corporate and individual competition in international markets, you cannot depart very far from the going fashions, and there is no doubt at all, because we have looked at various comparisons in our own industry, that we are competing in world markets with similar sized, similar product American companies. On the average, their effective tax rate is of the order of 47 per cent, and in some cases it is lower. Ours is of the order of 52 or 53 per cent, and we say that 5 per cent difference has a significant influence on the decisions as to where, say, a multinational corporation is going to place its new facilities. In order to give Canada these chances for growth that we think can be achieved, the corporate tax rate ought to be set in relationship to the U.S. rate. We should not be seriously out of line.

Senator Cook: This also applies to capital cost allowance, does it not?

Mr. Fowler: Yes, it does also apply. I did not take time to go into the capital cost allowance. This is one of the difficulties we are faced with in this White Paper. There is a whole host of uncertainties and soft patches in it. Capital cost allowance is one. They say, "We think we had better take a look at this later." The whole question of sales tax is going to be looked at later, but we do not know how it relates. If there is to be a capital gains tax, how does this relate to the estate tax? We do not know. So we are really being asked to look at a piece of the overall picture and, with great respect, I do not think this is really a comprehensive piece of tax reform.

Senator Cook: It leaves the law pretty uncertain, does it not?

Mr. Fowler: Frankly, I personally resist the notion which appears in the early paragraphs of the White Paper, where, in effect, they say, "Well, the things governments have to do are so important and so valuable that there is nothing can happen that can possibly interfere with the immediate take from the personal and corporate income taxes. This is a kind of sacred figure that has to be maintained." It does not necessarily have to be maintained from this block of taxes. Maybe in a complete revision you look across the whole thing. Maybe you do it by a value-added tax; maybe you do it by something like the DISC arrangement, which is another form of it. It is very difficult indeed to grapple with this White Paper, where you are only dealing with a piece of the field.

Senator Everett: You raised a very interesting point, this \$1.67 billion of reduction that your proposals would create. You say Canada will get that back by virtue of the growth the proposals will produce, but you also say that it may not. If it does not, is it your opinion that the difference could be achieved through the imposition of indirect taxes? We seem to be constantly in a box where we say that so much revenue has to be derived from the direct proposals of the White Paper, so we bounce the pluses and minuses around. I believe what you are saying is that there are two other concepts we could employ: one is to lower taxes and get subsequent growth; the other is to give more consideration to indirect taxes as a means of getting revenue. Do you think there is room in Canada for the imposition of a higher indirect tax?

Mr. Fowler: I ought frankly to tell you, senator, that at the time we wrote this brief we had not done as much work as we have subsequently done on the possible staging of our proposals over a five-year period. At that time we said: We think the growth will do it; we think the broader base of taxation will automatically yield bigger Government revenues; but if it does not, then, while you are getting going, you could resort to other forms of direct taxes, such as sales tax.

Now that we have made our calculations, we think that the growth is there and that it can balance the books year by year. When we send you the detailed working papers on this proposed staging and the apparent result that will be derived, I think you will feel that the assumption that growth will produce the necessary amounts, if you stimulate it, is a reasonable one.

On the immediate question that you asked, I think I would be less than fair if I did not say that I think there are not very extensive limits for extending the sales tax; I think they are already pretty high.

Senator Beaubien: Mr. Fowler, do you not think that the increases in salaries of the civil servants, including those of the members of the House of Commons and the Senate, will eat up most of that \$1.6 billion in five years?

Mr. Fowler: With the greatest respect to senators, I do not think they would be that greedy.

Senator Carter: Before we leave this line of questioning I should like to ask a question. You imply on one page of your brief that there should be some reduction in Government expenditures. We have heard

that suggestion before, but it seems to me that the people who make it do not give sufficient thought to the strait-jacket the Government is in in having to make the statutory expenditures. The Government is paying out \$11 billion a year, and it has to raise that amount of money, but 60 to 70 per cent of it is comprised of statutory expenditures, and there is only the balance left in which to manoeuvre. We are spending today in Canada at all levels of government some \$6 billion on health and welfare, and another \$6 billion on education. These two classes of expenditure are rising, and as we look to the future we can see rather heavy expenditures having to be made to control pollution. So, I am not quite as optimistic as you seem to be that out of this growth the Government can somehow reduce its expenditures, or that it can achieve all the revenue required.

Mr. Fowler: Senator, with respect, I do not think I said that Government expenditures should be reduced. I think that in a growing and expanding country the total Government absolute expenditures are going to rise. There is a built-in rise because you have more people and more things to do, such as you have mentioned. What I was trying to say was that I think that the proportion of the gross national product taken by governments ought not to rise, and this is contemplated in the White Paper. The amount that goes through public hands and public administration is now higher generally than in most countries. Certainly we are up in the select top list of countries so far as the amount taken out of the total gross national product is concerned. That amount should not be increased, as is contemplated, from 31 or 32 per cent to 35 or 36 per cent in four or five years' time, which is what is implicit in the White Paper.

The whole point of our argument is simply this, that in the kind of tax system we have, if you can expand your pie, if you can increase the total number of activities, and people, and work closer to your potential, and do not have a lot of idle machines and idle people around the place, then the fiscal dividend, as it is called, that comes out of that is quite extraordinary, and it will provide you with that extra flow in absolute terms, which will enable you to look after the larger number of people and some new things, and some old expanding things that are there. The whole concept is to get the machine working at full capacity, and one of several policies is that of stimulating it by means of the tax route. Then you are going to have an in-flow automatically from your system which will enable you to do the things you have to do without taking a larger proportion of the

gross national product to be administered by public rather than private hands.

Senator Carter: Following that line of thought, I can see where the White Paper discourages growth, but in our present system where are the defects?

Mr. Fowler: I think the main defect in our present system is that the corporation tax relative to that in other countries is too high. I think we have a discouraging element in the present system in the fact that the taxes on the middle income group, which embraces the younger, vigorous, and more mobile people, are startlingly higher in effect than they are just across the border. We are going to need to bring in people, and we do now, but I am sure some of my friends here who are right on the firing line can give you examples. For instance, if you want to bring in a \$25,000-a-year senior man up from the States you have to pay him from \$35,000 to \$40,000 in Canada, to keep him here.

Senator Cook: There has been a great deal of evidence given us to the effect that the proposals of the White Paper have had the effect of delaying development. Can you give us any examples in your own industry of where development has actually been postponed, shelved, or halted, because of the proposals in the White Paper?

Mr. Hamilton: I do not think, Mr. Chairman, we are in a position to give you any firm examples on this.

Mr. Fowler: Mr. Chairman, I would simply say this—and naturally I cannot disclose names . . .

Senator Cook: I was not asking for names.

Mr. Fowler: Let me say that I know of one. I do not know whether I made the point in my opening remarks, and if I did not then I would like to make it now, that this industry, because there is a rising world demand, is, generally speaking, running full, and demand is still rising. There ought to be some expansions—I hope on a moderate basis—of the capacity to produce pulp and paper in this country in order to meet the future demand. It takes two or three years to plan and build a mill. I have heard of several cases of senior executives in this industry who say: "I have a project that should go. I have looked at it, but I am so uncertain as to what the impact of this White Paper is going to be that I cannot do it." I cannot do any more than say that to you, but this has happened in three or four cases in my experience within our industry.

Senator Gelinis: Mr. Fowler, in your opening remarks you mentioned the possibility of future expansion of the industry. With high levels of costs and taxes, would you care to say what is the present rate of average return on invested capital in the industry?

Mr. Fowler: It is between 5 per cent and 6 per cent.

The Chairman: Shall we move along to another heading? I point out to you, Mr. Fowler—and I am wondering what your view on it is—that under the individual rate structure proposed in the White Paper is is said that we will lose, by reason of increasing the exemptions, a billion dollars, and, therefore, we will increase the rates in order to recover not only the billion dollars but \$1.255 billion. That is done by giving the increased exemptions to this middle group that you are talking about and which is very heavily taxed, and then including an element of an additional amount in the rate to take it back from them. That looks to me like an exercise in a vacuum. How do we know the middle group and the top group has any desire for the increased exemption? Do you see anything in the formulation of a tax system which would point against the granting of exemptions in certain areas, and increasing those exemptions in certain areas, and in other areas, where you feel the increase is not needed, than not giving it. After all, if the increase is not needed, why give it?

Mr. Zimmerman: Do you mean in regions or in income groupings?

Mr. Hamilton: Income bands?

The Chairman: Yes, why give it?

Mr. Hamilton: This is an application of the means test, if you look at it in the overall.

The Chairman: And a lot of people shudder when you talk about a means test.

Mr. Hamilton: That is not the right word.

The Chairman: Yes. Many violent speeches have been made at different times about applying the means test. However, in principle what possible objection could there be to extending the increased exemptions? If the word increased exemption bothers you, you could disguise it in the lower levels by simply saying up to a certain amount of income is not taxable. It could be defined by the dollar amount of income without referring to exemptions at all.

Mr. Fowler: We have not specifically considered this. However, speaking for myself I see no reason why a distinction as to exemptions cannot be made between income brackets.

A little difficulty might be encountered at the break point in working it out as a technical matter. However, I do not see anything wrong with it.

We say that the middle income group is taxed too highly. Do not increase it and as time goes on that is the area in which you should increase incentives by lowering in that group.

Senator Everett: Both the reporter and I would like to know what you mean by DISC proposals?

Mr. Fowler: I have been trying to think what the letters "D-I-S-C" mean.

Senator Molson: Domestic International Sales Corporation.

Mr. Fowler: That is right. It is a proposal current in the United States at the moment. They seem to have rejected the European type of value added tax and are now looking for ways in which they can make their exporting industries competitive against it.

As I understand it, the proposal is that they will allow corporations engaged in international trade to set up an intermediate corporation which will have special tax rights.

Senator Everett: The question of goodwill is dealt with at page 27 of your brief. The reason I want this on the record is that you raise something that has been raised by only one other witness. Most of the witnesses have been very happy with the write-off of goodwill under the White Paper.

You make a point as follows:

However, we question the proposed treatment of goodwill. In the first place, this is a tax on capital gain which we oppose in principle as outlined above. In addition, the proposed treatment would tax gains which accrued to the vendor regardless of when he purchased the business or of the value of goodwill at the start of the system. Thus it would, in effect, tax gains which accrued before valuation day. This retroactive feature is contrary to other proposals and should be amended.

Dr. D. A. Wilson, (Economist), Canadian Pulp and Paper Association: I do not think we can comment

much further, except to state that goodwill accrues over long periods of time.

I do not see how it would be possible to identify any goodwill that occurred after valuation day, except by a very difficult process of valuation at that time. It would simply be a retroactive tax in our view and it is not worth it.

Senator Everett: I believe the authors of the White Paper said that because of the deductibility of capital losses, if they were dealing with the goodwill value of shares over and above the value of the underlying assets they would have to create a situation in which there was no creditable tax for the difference between the value of the underlying assets and the ultimate valuation based on the goodwill of the earnings record of the company.

They say they have to do this because by virtue of the deduction of capital losses on the shares you could in effect sell creditable tax to other people.

You quite rightly point out that that sort of tax is retroactive and that in effect it will tax goodwill that was achieved before the system came into force.

Have you been able to devise any method to prevent the sale of creditable tax?

Mr. Brooke: Do not have creditable tax.

The Chairman: Are there any other questions on this phase, or shall we move on to some other point?

Senator Molson: We should move on to the valuation proposals. I do not think there is any comment in the brief on the five year valuation.

Mr. Fowler: I do not think there is; we do not like it.

The Chairman: That is very moderate language, Mr. Fowler. We have had stronger in the course of our hearings.

Mr. Fowler: Really this seems to be the ultimate end in complexity, difficulty, interference, all the things we ought not to have in the tax system.

Senator Molson: Do you believe that the proposals of the White Paper will make the task of reporting incomes by corporations and individuals in Canada any more difficult?

Mr. Zimmerman: I think it will make it vastly more difficult, particularly for individuals, if the White Paper proposals are followed.

It is difficult to speculate on the orporation arrangements because whatever ultimate corporate form will be most suitable under the sytem it certainly will not be any easier.

Senator Molson: The creditable tax phase would be a complication in itself.

Mr. Zimmerman: It is an almost hopelessly difficult task in the chain of corporations referred to in the proposal.

Mr. Fowler: A related point, as I mentioned before, is that these tax proposals would lead to a great many corporate re-adjustments, re-organizations and re-shuffles, which seems to be a rather pointless exercise.

Senator Molson: The reason I ask this question is that I have been considering during the last few weeks whether in fact the White Paper could be applied in full in this country at this time in the way it is written.

Would the mechanical complexities created not make it almost impossible? When I stop and think of the individuals and the corporations and what this means in terms of time, effort, expertise and consultation, I cannot help but wonder whether the whole proposal is practicable.

Mr. Fowler: Mr. Chairman, in very general terms a few minutes ago I made similar remarks.

I merely made the point that this country has a great deal on its platter at the moment. There are pollution and international trade difficulties. The country is worried about the Arctic, unemployment and inflation.

I do not think this country can stand the complexities and dislocations of the kind of system envisaged in the White Paper. It will grind us to a halt, just trying to alter our bookkeeping.

Mr. Hamilton: Bear in mind, Mr. Chairman, that this recommendation leading to excessive bookkeeping and consumption of paper is still being made by the paper industry.

The Chairman: You should be careful in speaking against something that would require a great deal of paper.

Are there any other items you wish to discuss? You can keep in mind that in some of the subjects you touched on in your opening statement, such as taxation of capital gains, we have had about every submission there is. We have also read your submission. There are also incentives. We had a big day on international income yesterday and we are aware of the problems. Is there anything you want to add?

Mr. Fowler: Only in a very general way, Mr. Chairman. I would hope that this fairly large industry might be a nice specific case for this committee to look at. When we look through the White Paper we can find virtually nothing that will stimulate the growth of this industry or improve its position. We can find a great many things that are working in the opposite direction. We think of the old song that said you should accentuate the positive, and this is one industry that, when you are dealing with tax reform, you ought to have in mind, with the potential for growth that it now has.

If I might just add this. I take it, Mr. Chairman, you will accept our detailed calculations when they have been worked out in the course of the next few days and how our proposals are likely to work out.

The Chairman: Yes. We would like to have them early.

Senator Cook: To a certain extent this point has already been covered. On page 24 you refer to capital cost allowances. You make the point, with which I entirely agree, that they should be dealt with at the same time as the other co-called tax reforms. You also mention, as I understand it, that instead of the present rates being generous, you consider them to be inadequate.

Mr. Fowler: We think that capital cost allowances can be used more effectively to stimulate growth than they are today.

Senator Cook: You make the point that they should also be larger because of the possible obsolescence that takes place in manufacturing plants and so on.

Mr. Fowler: This is one way to keep ourselves right up to date.

The Chairman: Mr. Fowler, on that point, the strongest witness you would have in supporting what you have said should be the Government itself, because it has made use of accelerated depreciation for the purposes of stimulating industry in certain areas.

Mr. Fowler: Yes, sir.

The Chairman: So there is no question that if you are looking for a vehicle to stimulate, this is a good place to look.

Mr. Fowler: The point is that if you succeed in stimulating growth in your period of rapid write-off, you get more taxes later on.

The Chairman: That is right. Are there any other points, Mr. Fowler?

Mr. Fowler: No, thank you.

Mr. Hamilton: Do you have anything further, Mr. Prentice?

Mr. Prentice: No, thank you.

Senator Blois: Before you close, the statement was made by a group recently that they did not agree with all the proposals in the White Paper but they could live with it. I am just wondering if the members of this group could live with the White Paper if all the proposals were implemented.

Mr. Fowler: It is a pretty tough industry, and I guess we could live, but it is going to be a smaller industry; it will be a less rapidly growing industry; it will be a less productive industry, less up to date.

Senator Flynn: Would it be less competitive?

Mr. Fowler: It will be less competitive.

Senator Flynnn: It depends a lot on export.

Mr. Fowler: I should have said that first. I think this White Paper, if implemented, will make this industry less competitive in world markets.

The Chairman: Thank you very much.

Mr. Hamilton: I should like to thank you, Mr. Chairman, on behalf of the industry and our group, for your thoughtful consideration of our proposals.

The Chairman: Honourable senators, to present the next brief we have Brinco, the British Newfoundland Corporation Limited. The delegation is led by Mr. Mulholland, President and Chief Executive Officer of Brinco. Is it proposed to proceed with both submissions at the same time?

Mr. W. D. Mulholland, President and Chief Executive Officer, British Newfoundland Corporation: Yes, sir, if that is agreeable to you.

The Chairman: Will you introduce your panel and make your opening statement?

Mr. Mulholland: Mr. Chairman, honourable senators: we appreciate this opportunity to appear before your committee and to discuss our submission with respect to the Government's White Paper on taxation.

I have with me today several members of our staff and advisors who will be pleased to assist this committee and answer any questions you may have.

On my right is Mr. Harry W. Macdonell, who is a vice-president of our company and of Churchill Falls (Labrador) Corporation. Mr. Macdonell has also for many years been an advisor to the Rio Tinto-Zinc Corporation Limited, and will be speaking to you later with respect to that company's brief.

Nest to Mr. Macdonell is Mr. James C. Wilson, a partner in the firm of Peat, Marwick, Mitchell & Company who are the auditors for both Brinco and Churchill Falls. Mr. Wilson has been of great assistance to us in preparing the brief which we have submitted to you.

Next to Mr. Wilson is Mr. Robert C. Berry, Vice-President Finance of Brinco and Churchill Falls.

Next to Mr. Berry is Mr. P.A.T. Keeping, a Vice-President of Churchill Falls (Labrador) Corporation Limited.

On Mr. Keeping's right is Mr. Patrick Lawlor, Assistant Manager Taxation for the Rio Tinto-Zinc Corporation Limited, who is principally interested in the brief of the Rio Tinto-Zinc Corporation Limited, which will be heard following the hearing of Brinco's brief.

Our brief has been filed with the secretary of your committee, together with a brief summary of the more salient points, and you will all have received copies of the Senior Advisor's summary of our brief. Under the circumstances, it would not be appropriate for me to deal with the brief in detail, and I will limit my opening remarks to what I consider the essential features of the brief.

Our company, British Newfoundland Corporation Limited, which I will refer to as Brinco, has been actively interested in the development of Newfoundland and Labrador since its incorporation in 1953.

At the outset, Brinco had seven shareholders, most of whom were resident in the United Kingdom. We have carried out an extensive program of mineral exploration, including some fairly advanced work in an area of uranium mineralization. We have brought into production a copper mine and mill near Springdale, Newfoundland, and we are now carrying out the development of a neighbouring ore body which we expect will appreciably extend the estimated life of this property. We developed the Twin Falls Power Project, and twice expanded it, in Labrador to support the iron ore developments at Wabush Lake and Carol Lake. We have provided management for the development of the Bay d'Espoir Power Project in Newfoundland for the owner, the Newfoundland and Labrador Power Commission. We have undertaken extensive surveys of water power resources in Labrador, and, as you know, have carried out an advanced study and field work at one site, Gull Island, on the Lower Churchill River. Finally, we are currently carrying out the development of Churchill Falls, our largest project to date. Since the company was formed we have raised over \$1 billion for the development of these various projects in Newfoundland. While these endeavours were under way we also increased the number of our shareholders from seven to over 22,000, and our Canadian ownership from nil to 40 per cent. That, in a few words, sums up our activities in recent years.

While we are, of course, very concerned about the aspects of the White Paper relating to mining companies, the impact of the White Paper proposals upon our interests in the Churchill Falls power development, which is being constructed by our 57 per cent owned subsidiary, Churchill Falls (Labrador) Corporation Limited, is so great that we have limited our submission to this latter problem. I should make it clear that our failure to comment upon the mining aspects of the White Paper does not indicate any lack of concern on our part, but a belief that the problems in this area have been adequately presented to your committee by many others.

Turning to our interest in Churchill Falls, we have summarized on page 13. . .

The Chairman: Could we just stop right there for a moment, Mr. Mulholland. Can we assume that you say you are not dealing specifically with the mining phases of the White Paper, knowing that we have had considerable representations and that you are aware of those representations and you share the views expressed?

Mr. Mulholland: That is true, Mr. Chairman. Turning to our interest in Churchill Falls, we have summarized on page 13 of our brief the effect of the various White Paper proposals on our shareholders with respect to income from Churchill Falls. This summary compares the effect of the present system with the effect of the proposed system. It will be seen that for a closely held corporate shareholder of Brinco there will be a reduction of between 60 per cent and 51 per cent in its after tax income and for an individual with a marginal rate of only 20 per cent a reduction of between 36 per cent and 22 per cent. I think it is obvious that the effect is so severe that one can assume that the initial equity investment in our company would not have been made under the proposed system and that future developments of this kind will be severely limited, if the White Paper proposals are adopted.

While our company and our shareholders are seriously affected by the same problems as other public utilities, I think our position is somewhat different from other utilities in a number of important respects:

First, Churchill Falls is constructing the largest hydro-electric power development in North America at a cost of almost \$1 billion. The decision to proceed with this development, the arranging of financing, the principal agreements with the Province of Newfoundland and the power contract with Hydro-Quebec under which power is sold at prescribed prices for 40 years were all negotiated on the basis of the existing tax structure. I emphasize the word "structure" because like any corporation we know that our tax position would not remain static. However, we did believe that in a politically stable country such as Canada we could reasonably expect that we would not suffer any significantly greater increase in tax burden than other taxpayers.

Secondly, because we are developing a hydro-electric power project in one province and selling all of that power to another province, our tax position is more complicated than that of other public utilities. As you know, the federal Government rebates 95 per cent of the tax collected by it to the provinces in order to assure that provincial revenues do not suffer by virtue of utilities being operated by private companies rather than by the provincial government.

In our case these rebates had to be shared between the two provinces. In this connection it is important to note that any reduction in the rebate from the federal Government to the provinces will fall not on the present recipients of the benefit of the rebate but

on the company. This is the effect of our agreements with the respective provinces.

Thirdly, Churchill Falls has not yet produced any power or received any revenue therefrom.

Senator Isnor: Would you please name those two provinces?

Mr. Mulholland: Newfoundland and Quebec.

It is simply incurring enormous capital costs and the effect of the integration proposals upon the future position of its shareholders with respect to capital cost allowance is a very significant factor which would seriously affect the cash flow of Brinco and greatly extend the time which shareholders must wait to receive a return from their investment.

Finally, our company has brought together a team of very talented individuals and accumulated a great deal of know-how relating to very large projects so that we have both the opportunity and the ability to bring substantial additional power facilities into production.

By way of background I would like to explain that while I have only recently assumed the position of President and Chief Executive Officer of Brinco and Churchill Falls, I have been closely associated with the Churchill Falls project since 1959 and am personally well aware of the enormous problems our company had to overcome to bring this project to fruition.

The first engineering studies on the Churchill project were started in 1956. Between 1956 and 1964 further engineering studies were carried on and constant negotiations were under way with potential purchasers of power and the various provincial governments. By December 31 of 1968 Brinco had invested more than \$115 million in the project without any assured market for the sale of its power or having completed financing of the project. As a result of the tremendous effort on the part of Brinco's executives and staff and the representatives of the two provinces involved, a power contract was finally concluded in 1969 and the financing was completed in May of 1969, a total of 16 years from the first engineering studies on this project. Even under the existing tax system, it will not be until 1977 that shareholders will receive their first return on their investment.

Under all the circumstances this has to be considered a tremendous achievement based upon faith of private investors coupled with energetic and intelligent leadership.

At the same time the development of Churchill Falls would not have been possible without the co-operation of the federal and provincial governments concerned. This background is, I think, essential to an understanding of our brief.

The Churchill Falls project is based on the sale of all its power to Hydro-Quebec at agreed prices for a period of 40 years.

Senator Hollett: All of its power?

Mr. Mulholland: Yes.

Senator Hollett: Doesn't Newfoundland get any?

Mr. Mulholland: There is a portion that is subject to recall from the Hydro-Quebec power project for consumption in Newfoundland if the need develops.

Hydro-Quebec, a Quebec Crown corporation, could not have been expected to purchase our power on a basis which would deliver part of the price it paid for power to the federal Government in the form of taxes which would not be payable on power it produced itself. Fortunately, the federal Government recognized the anomaly under which provincial governments were virtually forced to use only government-owned utilities in order to avoid power costs being loaded with federal taxes. In 1966 the then Minister of Finance, Mr. Mitchell Sharp, introduced legislation in the House of Commons providing for the rebate of 95 per cent of all federal taxes in respect of power produced in the province concerned. This made it possible to satisfy the requirements of the two provinces concerned with Churchill Falls.

Enactment of the Public Utilities Income Tax Transfer Act removed a serious obstacle to meaningful negotiations between Churchill, the Province of Newfoundland, and Hydro-Quebec. On the one hand Hydro-Quebec recognized that the Province of Newfoundland was entitled to a fair return for the development of power in that province, and on the other hand Newfoundland recognized that the Province of Quebec was entitled to a reduction in the price of power so that its consumers would not suffer a disadvantage because the power was produced in Newfoundland rather than in Quebec. As a result of lengthy negotiations the Province of Newfoundland agreed to limit the amount of tax it would retain in respect of the rebates and taxes collected on its behalf by the federal Government. The balance of the rebate is to be return by the Province of Newfoundland to Churchill Falls but only for so long as the power

contract is in effect; Churchill Falls has agreed with Hydro-Quebec that the contract price for power will be reduced by the entire amount of that part of the rebate returned to the company by Newfoundland. I would like to be quite clear on one point, namely that not one cent of these rebated taxes accrues to the company or its shareholders. In fact, as a result of inconsistencies in the system the company is moderately out-of-pocket.

Honourable senators, I think that you will appreciate that the Churchill Falls project could not have gone forward in the absence of the tax arrangements existing at that time or some other arrangements designed to produce similar results.

The scheme of taxation devised by the various governments involved, including the federal government, was ingenious and workable. It gave practical substance to the policy of the federal government announced in 1966 by the then Minister of Finance, the Honourable Nitchell Sharp which, briefly stated, was to place investor-owned public utilities on the same competitive footing as provincially-owned utilities, with the individual provinces left to decide which system or combination of systems they preferred. I believe this was a sensible policy when it was promulgated and remains so today. I would respectfully submit that subsequent results have more than confirmed the good judgment of the government which adopted this policy. I must point out however, that the suggestion in section 4.65 of the White Paper that the provinces could decide "to what extent they, the rebates, should be turned over to the corporations or its shareholders" completely ignores the fact of which the government is well aware, that in this very significant power project the rebates will have been either legitimately retained by the Province of Newfoundland or turned over to the consumer of power for a period of at least 40 years.

If it is the intention of the present government to effect a reversal of the policy with respect to public utilities then it should say so in a straightforward manner so that the question may be discussed on its merits—and not mask its intentions in the intricacies of the White Paper proposals. Further, honorable gentlemen, may I suggest that if it is the decision of the government to adopt policies designed to discourage by means of punitive taxation companies such as ours from undertaking projects like Churchill Falls then simple equity demands that it be applied prospectively not retroactively.

Regardless of how much one might deplore such a decision, one must recognize the authority of the

government in this field and its undeniable right to change its mind. There are some of us, however, who feel that our company is not undeserving of your continued confidence—which we earnestly solicit—that we have served our provinces well, Newfoundland which has entrusted to our stewardship an important part of its natural resources, and Quebec which has entrusted us with the responsibility of providing for an important part of its power requirements. We take these responsibilities very seriously. It has often been said that some national significance attaches to our work. I have no comment on this one way or another, but I might say that we have been of some help in meeting some very pressing human needs in our part of the world. It might also be said that we are getting on with an important job which needed to be done—one which a great many people said could not be done; that we have somehow coped with the many problems, some self-publicized; and, above all that we have never asked for nor received a cent from the government. We have, I think, turned a few eyes toward Canada, we have advanced the state of the art in a field—the planning, financing and management of large projects—which is important to Canada, and we have sparked a feeling of pride and excitement in some people. In the end, people are what this effort is all about—not waterfalls nor giant excavations nor record breaking bond issues—how to get the world's work done in a way that allows people to have a sense of fulfillment instead of frustration and, most important of all, to share in the adventure. Perhaps we have had some success in this, too.

It may be of interest to you to learn that some knowledgeable observers feel that we here in Canada have devised a vehicle and a technique for development which will be widely imitated elsewhere in the world. Our team, which is a truly exceptional group of people, spends a considerable amount of time sharing its knowledge and experience with people from all parts of the world.

I might add, as an aside, that we were asked the other day to send a team to the United Kingdom to make a presentation to the British Government on the organization and planning of this project.

I would like to feel that our goals are shared by others and that our efforts are not at variance with the aspirations of the nation at large. If this is so, then I would ask of government that, if it cannot assist, it at least not hinder us in carrying out our work.

Honourable senators, whether by design or inadvertence, the proposals contained in the government's White Paper pose a grave threat to our company and

to our shareholders. I cannot bring myself to believe that it is by design, for nothing in our experience of the Minister, of his officials and of their respective predecessors in office would lend credence to any expectation other than that of fair and honourable treatment at their hands. One must observe, however, that once the damage is done, small comfort can be derived from with treatment.

The relevant White Paper points here are:

First, that Churchill Falls will pay full tax to the federal Government and this tax will be properly disposed of to beneficiaries other than the company. In these circumstances, the shareholders of our company should be entitled to credit for the taxes paid in the same manner as other corporations.

Secondly, the fact that the Newfoundland Government will return a rebate to Churchill Falls which will be reflected in a reduction of the price for power will involve substantial additional taxes on the distribution of Churchill's income because for tax purposes they will result in part of the company's income being considered as untaxed income.

Finally, returning to the question of capital cost allowances, I have already made reference to the fact that in the case of Churchill Falls a period of 21 years will have expired between the time of making the first investment in the project and the time when shareholders can expect to receive their first return on their investment. While Churchill Falls is a particularly big project, I think it will always be true that there will be a large span of years between the making of an investment and a return on an investment in this type of industry, and I am very concerned about the effect of the integration proposals and capital cost allowances as they affect capital-intensive projects with long lead times between investment and return.

In reading other briefs presented to this committee and general comments on the capital cost allowance question, it does not seem to me that it has been generally appreciated that the effect of the integration proposals is most likely to be to delay substantially the payment of first dividends by a corporation undertaking a new development rather than to yield additional taxes. It also does not seem to be generally appreciated that the effect of integration on capital cost allowances is to substantially increase taxes whether or not deferred taxes are distributed to shareholders. In other words, the shareholder will be adversely affected without receiving any direct benefit from the taking of capital cost allowance at the full prescribed rate. This point is dealt with in detail in our

brief, but the point that I should like to impress on this committee is that in the case of Churchill and indeed similar projects, the net effect of the integration proposals on capital cost allowances is most likely to be that the first return on investment will be very substantially delayed, thus making all such projects very difficult to finance.

Very large construction projects involve some special problems most of which are fairly obvious. Very long construction projects have some special problems which are not so obvious and are not at all well understood. It is important that there be organizations able and willing to undertake very large and very long projects because this is the pattern of future resource development not only in Canada but elsewhere in the world. It is equally important that sources of finance for such projects be preserved and expanded. This is a matter very largely of investor confidence.

Today, we feel that tools and techniques are available to permit one to plan and carry out with confidence a several hundred million dollar project over an extended time period provided circumstances are such that one can conclude that the possibility of political, economic and social instability resulting from unwise public policies is remote. The hazards we worry about are of this nature, and the longer the time period involved, the greater these risks become. So, one must have confidence in government before embarking upon such an undertaking. Unfortunately, few governments these days seem able to inspire this confidence, which is a pity, because private enterprise still remains the most powerful, most flexible and most creative force in the world for getting things done. While a growing segment of business around the world seems to be taking an ever longer view and planning for the future to a degree undreamt of two decades ago, this trend does not appear to be characteristic of governments.

You are all, of course, familiar with the concept of compound interest. For example, \$62.09 invested at 10% compounded annually will grow to \$100.00 in five years. Looking at this formulation a little differently, one could say that the present worth of \$100.00 payable five years hence, discounted at 10% per annum, is \$62.09. If the \$100.00 were, however, payable in ten years instead of five, its present worth on the same basis would be only \$38.55. Stating the issue in still a different way, if we start a project with an investment of \$38.55 and we expect a period of five years to elapse before realizing upon our investment, we would require a payment of \$62.09; on the other hand, if the period were ten years, the required

repayment would be \$100. This is the crux of one of the problems peculiar to a long construction project. The long period during which the investment earns no return imposes a heavy cost. Accordingly, proposed tax measures which have the effect of further deferring cash flow from a project tend to compound greatly the already difficult conditions under which such projects have to be undertaken and will unquestionably be a serious deterrent. The implementation of such measures would not be a constructive step.

Before concluding my remarks, I would like to impress upon this committee that the combined effects of the White Paper proposals will not only effect a much greater reduction in shareholders' earnings in Churchill Falls but will make it virtually impossible to finance similar projects in the future, thus putting entirely upon Government the cost of producing power so desperately needed for the development of our Canadian economy.

I think it can be fairly said that Churchill Falls is an outstanding example of what can be achieved when private capital and governments, both federal and provincial, work in close harmony.

The White Paper proposals, if adopted, would change the whole basis upon which the Churchill Falls project was founded. What is at stake here is not only the direct effect of the White Paper on this and future projects but also the ability of investors to assume that government will take responsibility for the fair treatment of investors who have acted in good faith on the basis of existing laws. I do not suggest that governments should not make changes in the tax system but I do suggest that in making such changes, they should avoid severely prejudicing particular forms of investment in relation to others, especially where that investment could not have been expected to take place if it had not been for the legislation then in effect.

Thank you, Mr. Chairman and gentlemen, and we would be happy to answer any questions you may have.

The Chairman: I have a couple of question, Mr. Mulholland. The particular portion of the White Paper that you referred to, that is the part dealing with the treatment to be accorded to public privately-owned utilities—at the present moment your utility is not in a position where it has any income, is that correct?

Mr. Mulholland: Churchill Falls has a slight income from its holding in Twin Falls and Brinco does as a result of mining income, that is generally true.

The Chairman: It is paying some income taxes then, is that correct?

Mr. Mulholland: We are not, because of write-off.

The Chairman: Well, at some stage you become very concerned over what the White Paper calls creditable tax, and the denial of the right of your utility to use or to earn that creditable tax. We had a field day here the other day, and we had quite a number of these public privately-owned utilities in before us, and therefore we have acquired an understanding of the problem. I suppose the problem simply stated is that the White Paper confuses taxation and distribution. Quite obviously under the Public Utilities Income Tax Act, it deals with distribution, and that is the distribution of a percentage of the tax that is collected from such utilities and then it makes a payment of that money to the provinces and the provinces may, insofar as that legislation is concerned, apply it in any way they like. I think Alberta is the only province that applies it as a reduction in the monthly account that goes out to the consumers of power. The other provinces, we are given to understand, put the money into their consolidated revenue funds. So it is quite obvious that the utilities pay taxes.

Senator Isnor: Mr. Chairman, would you repeat what you said about the other provinces?

The Chairman: They put the rebate into their consolidated revenue funds and then it presumably gets allocated for whatever purposes the Government has in mind at the moment.

Senator Carter: In your brief you say that the Newfoundland Government gives back as a rebate a percentage of what it takes. Could I ask what that percentage is?

Mr. Mulholland: They rebate to the company who in turn passes it on in the form of a tariff to Quebec Hydro all moneys collected by them through this mechanism of the federal Government in excess of 22½ per cent of our taxable income.

The Chairman: But that is by agreement with the Province of Newfoundland?

Mr. Mulholland: That is by a three-way agreement between Newfoundland, Quebec and the Company.

Senator Hollett: Could you tell me how many employees you have from Newfoundland and how many

from Quebec? I am speaking now of the British Newfoundland Corporation.

Mr. Mulholland: In our corporation?

Senator Flynn: On the site itself.

Mr. Mulholland: I could not tell you that, because I do not know.

Senator Flynn: But the site itself is in Newfoundland.

Senator Hollett: Well, what is the proportion? Can you tell me that?

Mr. Mulholland: At the site?

Senator Hollett: Yes.

Mr. Mulholland: The majority have their homes in the Province of Newfoundland, but I cannot tell you the exact percentage. It is probably 60-odd per cent, or something like that.

The Chairman: Well, it is a figure that is available and you could supply it to us.

Mr. Mulholland: Sure.

The Chairman: We will get it for you, Senator Hollett. Mr. Mulholland, Senator Hollett is from Newfoundland and so he has a great interest in this.

Mr. Mulholland: This figure, of course, involves dozens of different employers and we get it, of course, because we do follow it, but we have to collect it from a whole raft of different people.

Senator Hollett: You say that 43 per cent of your capital came from Newfoundland and Quebec. Can you tell me what percentage came from Newfoundland? You say that your Company owns 57 per cent of the issued capital and the remaining 43 per cent by Newfoundland and Hydro-Quebec. I am sorry, I thought you said Quebec.

Mr. Mulholland: It is Hydro-Quebec. Newfoundland Power is 9 per cent and Quebec would be the difference between 57 and 9 which would be 34.

Senator Flynn: The rest is privately held, but I think it was suggested that there was a part held by Canadians. What is their proportion of the shares held?

Mr. Mulholland: That is Brinco, and not Churchill Falls, and it is 40 per cent held by individual Canadians.

Senator Flynn: Now if the rebate of tax is denied to Canadian shareholders, of course you will either have to increase the dividend or there will be a tendency for the shareholders to sell their shares. I think this was explained to us by some of the others who were before us.

The Chairman: Well, senator, it is not the rebate. The rebate is made by the federal authority.

Senator Flynn: But I am speaking of the 20 per cent rebate on the dividends. This will be denied to these shareholders and so they will be in an unfair position with respect to other investments, and I think it has been explained that this could result in these shareholders selling their shares to non-resident persons.

Mr. Mulholland: If I understand your question correctly, senator, I think the answer is that these shareholders will be denied the benefit of creditable tax as other shareholders are arising from the fact that Churchill Falls pays federal income taxes. If that is what you said, then that is correct. That would be the result.

Senator Flynn: Would the consequence be the one I just mentioned, do you think?

Mr. Mulholland: Well, a good deal of adverse consequence has already occurred as a result of the announcement of these proposals, and the ability of everybody to interpret what their effect would be if implemented. As you are doubtless aware, utility stocks generally in Canada have been depressed presumably because of the potential effect of these proposals. So that selling one's shares is not really a wholly satisfactory way of avoiding the consequences, because some of the consequences unfortunately are already being borne by these people amongst whom I happen to include myself.

Senator Flynn: But I think it was indicated, Mr. Chairman, that the result would be that the Canadian taxpayers would be denied a 20 per cent rebate and would be at a disadvantage to that extent. But, furthermore, with regard to the other shareholders, non-resident shareholders, they would pay only 15 per cent on the dividends and, therefore, there would be an incentive for non-resident individuals to become shareholders of these companies.

Mr. Mulholland: I do not think that is necessarily so. The impact on some classes of non-resident shareholders, is also very severe, and in some cases is even more severe.

Senator Flynn: But on this point, which has been explained to us previously, I would like your comments.

The Chairman: What these utilities said was that it would be more attractive to a non-resident to purchase the shares of what I call public privately-owned utilities than for a Canadian.

Mr. Mulholland: Yes, but you have to be specific, of course, on what sort of non-resident, because it makes a difference.

The Chairman: They were talking in terms of the U.S. resident.

Mr. Mulholland: Mr. Chairman, if I might speak to that point. The utilities, in general, did make that point in their briefs. I think the point is true, when you talk about the non-resident direct investor, and it is particularly true if it is a U.S. investor who acquires more than 10 per cent of a Canadian utility, in that he is not subject to the equalization tax in the United States.

As Mr. Mulholland has stated, if, however, the non-resident were to hold his interest in a utility through a Canadian company, in fact, the tax would be very much higher than he would suffer under other forms of investments.

The Chairman: Without these qualifications, the statement was made to us that the shares would be more attractive for a U.S. investor—and I think they were talking about individuals—than for a Canadian individual investor.

Mr. H. W. MacDonell, Vice President, British Newfoundland Corporation and Churchill Falls Ltd: It certainly might be more attractive compared to other forms of investment, because, on the price structure, they would be relatively more attractive to the non-resident.

The Chairman: Remember, they were talking about the utility companies that were paying dividends, and they were looking at that factor too.

Senator Flynn: It could eventually be your case, we hope.

The Chairman: Yes.

Your problem is tied up in the proposed treatment of the taxes that are collected by the federal authority and then distributed to the provinces, and the effect of the proposed integration provisions and creditable tax in those circumstances.

Mr. Mulholland: To a degree, we have a problem similar to that faced by other utilities, and a somewhat more acute one because we operate in two provinces, in effect. Of course, we cannot just go out and raise our rates to compensate for the loss that would be borne as a result of these proposals. To varying degrees, other companies do have means of alleviating the effects—some a little, some more, and some perhaps appreciably. We probably have no flexibility in that regard, due to the very special nature of this project and the arrangements that have been made. We have further problems arising out of the integration proposals, and we have, of course, a very serious problem, as does any new project, because of the proposals with respect to capital cost allowances.

The Chairman: Would you care to develop the capital cost allowances aspect of it? Is the point that capital cost allowances reduce your earnings and reduce your taxes, therefore? Is that some aspect of it, or what is the aspect of capital cost allowance that you are concerned about? Is it the sort of suggestion in the White Paper that they are going to have a good look at capital cost allowances because they have an idea they are too high?

Mr. Mulholland: What we think will happen is that as a result of these proposals being implemented we will have the choice in, say, the year 1977 of making a distribution to shareholders, and we pay dividends in cash, of course. There is no serious doubt in our minds that we will have the cash, but we have the benefit of capital cost allowances, and that accounts for a very substantial part of the cash flow from this project because of its capital intensive nature.

Now, if we pay out funds to shareholders, that does not carry a creditable tax. So, in the hands of Brinco and of our individual shareholders and corporate shareholders, they see a very drastic increase in the taxes versus what they have to pay on the dividend paid today.

There are two likely alternatives. One, of course, is not to take the capital cost allowance, in which case you are not really helping matters any because you increase the amount of taxes which you will have to

pay in Churchill Falls and, therefore, reduce your cash flow by that amount. The other possibility is that you do not pay any dividends at all, and that certainly does not help the shareholders.

The Chairman: Or would not help you to get more shareholders.

Mr. Mulholland: Correct.

Mr. MacDonald: The problem really is that you can take capital cost allowances at a greater rate than you may necessarily have to take for accounting purposes. The result is that you defer a certain amount of tax. The amount of money which is distributable remains the same, but in the one case it is taxable without any offset, without any credit, and in the other case there is creditable tax. Therefore, you can expect, I think, that the economics will determine the shareholder is better off if the tax is deferred, but he does not get a dividend until a later date. So the result is, in fact, there will be no additional tax; there will be a deferral of the dividends.

The Chairman: Yes, but what is said is that you have a return which you make for tax purposes, and you have a corporate return which is the company's accounting of its housekeeping. They do not necessarily agree. While for tax purposes you may take the full allowances you are entitled to, if you have income enough to support that, for company purposes you may take something less and treat the difference as a deferred tax. That is the way of keeping up your cash flow.

Mr. MacDonald: That is correct.

The Chairman: In those circumstances, your cash flow would remain the same. For instance, you have \$1 million of taxable income, and you take your capital cost allowances which might reduce it by \$200,000 or \$300,000 but you do not pay out that money at that stage, and in accounting to the shareholder you may account for something less than the full amount of capital cost allowances that you have taken.

Mr. MacDonald: Yes, that is correct, but if you do not pay out the money, of course, you delay the return to the shareholders.

The Chairman: Yes, and the problem that arises is that if the attitude of the White Paper that you referred to in, I think, paragraph 4.65, is not changed then

the shareholder is going to have to come up with a substantial part of the dividend that he receives depending upon his marginal rate, because he will not have creditable tax.

Mr. MacDonald: What you have is a new form of double taxation.

The Chairman: Well, you have a very onerous form of double taxation.

Mr. MacDonald: It is, indeed.

The Chairman: Everything that we have talked about so far seems to come right back to this question that is raised in paragraph 4.65, and that is the proposed denial to the shareholders of privately owned utilities of entitlement to creditable tax, even though the company has paid the tax. Is not that the nub of your problem in Brinco?

Mr. MacDonald: That is the nub of the problem. There is no question about that. But, of course, one result might be that no additional tax is paid because you simply do not pay the dividend until you pay the tax further down the road. That would mean, in effect, that you have delayed the return on your investment, and Mr. Mulholland has pointed out the difficulty in extending the lead time on the term of investments of this type.

Mr. Mulholland: Looking at this very broadly, the critical thing, of course, is to make sure you do not create conditions in which things cannot get done and projects cannot get started, and the country cannot build. This is what this comes down to. It aggravates an already difficult situation.

The Chairman: As you go along and earnings come in, to what extent would you say those earnings are required for future commitments and developments you have in Newfoundland?

Mr. Mulholland: The long range corporate concept in Brinco and its group of companies is that on the completion of this project we will have a very substantial amount of regular income which we anticipated would be reinvested to a very large degree in other developments in that part of Canada. The tragic effect of this is to make that policy untenable.

The Chairman: I can see how it would make it untenable, because it would make it unattractive to equity capital.

Mr. Mulholland: Certainly. It makes it very, very difficult, and not just in respect of equity, to finance a very large project. It is very unfair to your shareholders.

Senator Cook: On pages 14 and 15 you mention that you have under consideration the development of hydro-electric power at Gull Island on the Lower Churchill River which is estimated to cost approximately \$500 million, and you say:

The White Paper proposals would seem to make the building of the project impossible as either the power price would not be competitive or the return on investment would be so low as to make it impossible to attract the necessary equity capital and to provide the necessary interest cover on the funded debt.

The Chairman: I think the important words there are "would seem to make the building of the project impossible". Can you go a little more firmly on that?

Mr. Mulholland: I think the only reason for using the cautious term "would seem" is that conceivably there is a method of doing it that none of us have been able to think of. Perhaps a fairy godmother will come on the scene, or we will discover some means not yet known to man. We do not know a way of getting around this problem. I suppose there is a remote possibility that some genius will think of one.

The Chairman: The great White Father, which is one way some people have of describing the Government, might provide more money.

Mr. Mulholland: We do not really want the Government's money. We never have, and . . .

The Chairman: You are not counting on it, and it is not your policy?

Mr. Mulholland: Yes.

Senator Cook: In Labrador, since the incorporation of Labrador Mining and Exploration Company, of which I was one of the incorporators in 1936, you will have spent when you have completed Churchill Falls something of the order of \$1 billion, will you not?

Mr. Mulholland: Yes.

Senator Cook: And with the two mining companies, the Wabush group and the Iron Ore Company of

Canada, you will have between you spent almost another \$1 billion.

Mr. Mulholland: I do not really know the amount, but that sounds reasonable.

Senator Cook: That includes the building of the railway and the development of the mine.

Mr. Mulholland: Yes.

Senator Cook: Before this amount of approximately \$2 billion was spent in Labrador there was nothing there except a few birds, and so forth?

Mr. Mulholland: There were only seasonal trappers and fishermen.

Senator Cook: One witness told us that had the White Paper proposals been in force before this development was started, then it would never have taken place. Would you agree with that statement?

Mr. Mulholland: That sounds reasonable to me. I am confident that the Churchill Falls development would not have taken place had the White Paper proposals been in effect. As you know, my job was finding the money for that project.

Senator Cook: So we have a completely barren part of Canada on which, under the old rules, \$2 billion approximately has been spent, and that is going to yield a vast amount in taxation to the treasury, and it has provided a great deal of employment. It is the considered opinion of those who are close to it that if the rules of the game were different, and had the formula in the White Paper been in effect, that development might well have not taken place?

Mr. Mulholland: Yes, sir, and as you doubtless appreciate, although many people do not, that when you go into an area like that it is not just a matter of constructing a plant. There is the expense of building the roads, the towns, the schools, the hospitals, and all the other things. You are dealing with virgin territory, and you have to create communities. That took a lot of money and a lot of time and a lot of thought, because you can just uproot people and plunk them down on the frontier where they cannot live normal lives and educate their children, and everything else. You cannot create communities by snapping your fingers.

Senator Cook: Irrespective of whether the White Paper proposals are favourable or unfavourable to Brinco and its shareholders, or to the Iron Ore Company and its shareholders, they just do not make good economic sense.

Mr. Mulholland: It has a very adverse effect on the future development of this part of the country, which is the majority of the land area of Canada, unless you deliberately want to adopt a policy of making it a bird sanctuary.

The Chairman: Or a national park.

Mr. Mulholland: Yes. Unless you want to leave it untouched forever more, this does not make sense

Senator Cook: Speaking as a Newfoundlander, it does not make sense.

Senator Carter: Have the White Paper proposals had any effect on the work that is going ahead at the moment, and if they go into effect will they affect the development before the work is completed? In other words, will they slow down the project?

Mr. Mulholland: No, sir, we will carry on the work at the Churchill Falls project on schedule, regardless of what happens in this respect.

Senator Carter: Then they have no impact upon your present financing?

Mr. Mulholland: Our financing is concluded, thank goodness.

Senator Gelinis: What about this long term contract with Hydro Quebec? Is there a clause in it whereby the contract will be renegotiated if the White Paper proposals are put into effect?

Mr. Mulholland: No, but there are provisions regarding the adjustment of the tariff relating to capital cost, which is a one time readjustment really when you finalize your capital cost of the plant. There is another one with respect to foreign exchange which protects us against losses, because most of our financing is in United States dollars and the commercial transaction is in Canadian dollars.

The Chairman: Is there any escalation provision for rates?

Mr. Mulholland: There is no general overriding escalation provision.

Senator Gelinis: If and when you go ahead with the Gull Island project, as I am sure you will. . .

Mr. Mulholland: We would certainly like to.

Senator Gelinis: . . . will that power be directed to Hydro Quebec, or will it be exported?

Mr. Mulholland: There has not been any decision on that. This is in the realm of a commercial problem that is facing us. Like any other project you have to get down to the job of selling the product.

Senator Carter: Could you operate at a profit under the White Paper proposals vis-à-vis your present contract?

Mr. Mulholland: Yes.

The Chairman: Do you mean if the White Paper were implemented?

Mr. Mulholland: Yes.

The Chairman: But the net profit would be reduced, is that right?

Mr. Mulholland: Yes; the most onerous effects are on our shareholders, both corporate and individual. It is a very serious effect.

Just because a man only has \$2,000 invested in shares and we are not dealing in millions of dollars does not mean that, relatively speaking, it is not just as serious and acute a problem to him and just as worthy of our attention.

Senator Hollett: I fished off Hamilton Inlet when I was a young fellow, I flew over Churchill Falls, as it is now called, 15 years ago when very little had been done.

I heartily agree with the president's statement that there would have been no development there as far as he can see had the White Paper been in effect. I am quite sure that nothing could have been developed under the terms of the White Paper.

These men also are going down there every once in a while. They risk their lives. We recall the tragedy of a few months ago. We not only have to hand it out to the Government which makes laws, but to these pioneers who enrich our country.

Therefore, if the White Paper is going to stop or delay development, we have to do something about it very quickly.

Senator Flynn: If the effect of the denial of the 20 per cent tax credit to resident Canadian individual shareholders will be to diminish their number and increase the number of non-resident Canadian individual shareholders, the result as far as the Government is concerned will be a decrease in income tax.

Individual non-residents pay less tax than resident individuals. Therefore it would be a loss to the Treasury if this was a consequence of the implementation of this proposal.

Mr. Macdonell: When you raised this question earlier, senator, I do not think I answered adequately.

The other utilities have pointed out that if they are to maintain a rate of return to their shareholders necessary to compete for capital with other industries they will have to raise their price of power very substantially. Therefore, because the non-resident does not suffer some of the disadvantages of integration, it would become a very attractive investment to the non-resident.

In our case, because our power is sold at a fixed price over 40 years, that is not necessarily the result.

Senator Flynn: It could be worse in your case?

Mr. MacDonald: It would be simply unattractive.

Senator Flynn: You could not adjust yourself to this problem?

Mr. MacDonald: That is correct.

The Chairman: Mr. Mulholland, are there any other aspects of the BRINCO submission you wish to discuss?

Mr. Mulholland: No sir.

Senator Cook: The White Paper suggests that the capital cost allowances might be on the generous side and will be considered.

Bearing in mind the necessity to finance these projects and all the other ramifications, do you think there is much leeway to reduce the present rate of the capital cost allowances?

Mr. Mulholland: It is hard to generalize. The capital cost allowance was a very great benefit to us in this project.

If the purpose of having capital cost allowances as they exist today is to stimulate investment, they certainly tended to fulfil their purpose in the case of the Churchill Falls project.

During the construction period of the project, from 1967 to 1976, which is a very long time, there will be no revenue from 1967 to late in 1972.

Revenue commences in 1972 from the first generating units to go into production. This revenue gradually accelerates as time goes on until 1976, when the last one is installed.

Over this construction period, I am referring to the total capital cost of the plant and the necessity to raise the funds, approximately \$150 million is generated internally. That includes the depreciation or capital cost allowances, deferred taxes and some earnings during this interim period.

That money, of course, up to the end of construction is simply re-invested in the project to pay wages, buy cement and all the rest. However, that is \$150 million that we would have had to obtain elsewhere. Therefore it is very important.

Senator Cook: This is a proposal for tax reform. In order to determine what taxable income is, you must know what depreciation rates are, do you not?

Mr. Mulholland: Yes.

Senator Cook: Do you not think that it is important for the Government also to make proposals as to what the capital cost rates will be when they make proposals for tax reform?

Mr. Mulholland: Yes, our normal, straight line depreciation rate on a project such as this, with a very long life, is only about 1½ per cent per year. The capital cost allowances were 6 per cent on the declining balance, which is a substantial difference.

Those funds which we generate by deferring our taxes until later years are very important to us. We put the money back where it will do some good for several years. It is a great aid for financing, which is not to be sneezed at in these times, because it is very difficult to raise these sums of money.

My broad answer to the Government in this regard is are you getting your money's worth? Is what you expect to happen as a result of these proposals, deferral of the Government's revenues as well, which have to be raised elsewhere? That is not right or wrong per se.

The answer lies in the answer to the question: Did you get what you set out to buy?

The Chairman: In other words, have you a viable project which will produce tax revenue?

Senator Cook: That is right.

The Chairman: What you are saying, Senator Cook, is that possibly coupled with the White Paper proposals there should be a proposal dealing with integration of taxes.

Senator Cook: Yes. What is taxable income?

The Chairman: May we move on to the brief of Rio Tinto-Zinc Corporation.

Mr. Mulholland: Yes. I have already introduced my colleague, Mr. Macdonell. I will ask him to carry on.

The Chairman: Do not think you are completely released, because there may be questions.

Mr. Mulholland: I will be prepared.

Mr. MacDonell: Mr. Chairman, honourable senators, I have been asked to speak to your committee on behalf of The Rio Tinto-Zinc Corporation Limited of London, England.

Many of the gentlemen here who appeared as witnesses for British Newfoundland Corporation Limited are familiar with the matters referred to in the Rio Tinto-Zinc brief. It is not necessary for me to reintroduce these gentlemen to you except to say that Mr. Mulholland, the President and Chief Executive Officer of British Newfoundland Corporation and Churchill Falls (Labrador) Corporation, is also a director of The Rio Tinto-Zinc Corporation. Mr. Patrick Lawlor, who is permanently employed by The Rio Tinto-Zinc Corporation in its head office as a taxation manager, has come to Canada specifically for this hearing. He is prepared to answer any questions you may have with respect to the company's operation in other parts of the world.

I do not intend to review the brief presented by Rio Tinto-Zinc in detail, but I think it may be helpful if I discuss some of the more significant aspects of the brief. The brief contains a fairly extensive description of Rio Tinto-Zinc's interests throughout the world, and we have included for your assistance a copy of a brochure entitled "RTZ Explained", which I think would provide you with most of the general information you may require.

As you know for Mr. Mulholland, Rio Tinto-Zinc has a 43 per cent beneficial interest in the shares of British Newfoundland Corporation, whose brief you have just discussed.

Rio Tinto-Zinc's other major interest in Canada consists of a 51 per cent beneficial interest in Rio Algom Mines Limited, which is one of Canada's major uranium producers and the largest producer of specialty steels in the British Commonwealth. In addition, Rio Algom owns and operates the Poirier mine in Quebec, has a major interest in the Anglo-Ruyn copper mine in Saskatchewan, and is presently actively engaged in developing the huge Lornex copper mine in British Columbia. Rio Algom has filed a separate brief with your committee, but has not requested a hearing, in the belief that many of the points raised by it have been dealt with by other mining companies and associations. Rio Algom has, however, indicated its willingness to appear before this committee if the committee wished to hear from it on any particular point.

I should also say here that Rio Tinto-Zinc as an investor will suffer from the results of the proposals which will affect mining and utility companies, but the Rio Tinto-Zinc brief deals principally with the further effects upon it as a non-resident investor. There is no need for me to repeat the problems affecting utility companies, and the proposals affecting mining companies are dealt with in the Rio Algom brief. However, before turning to the specific questions in the Rio Tinto-Zinc brief, I should like to express our concern that mining companies will, we think, under the proposals suffer greater combined federal and provincial taxes than most other industries, notwithstanding the compelling reasons acknowledged by the White Paper for granting incentives to this industry. For this and other reasons we feel strongly that a much more attractive basis for depletion allowances is necessary if this industry is to attract the capital vital to its growth.

Turning to the position of Rio Tinto-Zinc as a non-resident investor, extensive information is given

in Rio Tinto-Zinc's brief with respect to its investments in Canada and elsewhere. I think that two particularly significant features clearly emerge from this background. First, the Rio Tinto-Zinc Corporation has been and is a developer of new resources and undertakings, and as such can fairly claim to have played a very significant role in the growth of Canada—a role which it hopes to be permitted to continue. Secondly, the company has been a good corporate citizen of Canada. The Canadian companies associated with Rio Tinto-Zinc have been managed in Canada and have operated autonomously for the benefit of these companies and Canada.

Canadians have had a substantial opportunity to participate in the growth and development of these Canadian companies by holding approximately 40 per cent of the total equity in both Rio Algom and Brinco. These equity holdings of Canadians have a present market value in excess of \$100 million. The fact that the Canadian companies in which Rio Tinto-Zinc has invested have substantial Canadian shareholdings, coupled with the fact that new resources have been developed, give rise to most of the significant problems affecting Rio Tinto-Zinc under the White Paper proposals. If Rio Tinto-Zinc had owned the Canadian undertakings directly, or the Canadian companies had been wholly owned subsidiaries of Rio Tinto-Zinc, most of these problems would not have arisen.

As you are aware, under the proposals a shareholder of a Canadian company can only claim credit in respect of underlying taxes actually paid by a dividend paying corporation. This is the problem referred to by the chairman when he referred to item 4.65. This, I think, is one of those proposals which on a superficial examination only appears fair. This is, until you examine the circumstances under which untaxed income can arise. These circumstances fall into four categories:

(1) Cases where the income has in fact been taxed but the tax is not credited, such as utility income and dividends from controlled subsidiaries in treaty countries where tax, of course, has been paid to the foreign country;

(2) Cases where the tax is merely deferred of the taking of capital cost allowances;

(3) Cases where the income has been effectively taxed but is for some reason technically treated as untaxed. An example of this is the rebates which Churchill Falls receives from the Newfoundland government but which are in fact reflected in the price of power;

(4) Cases where tax relief, such as depletion allowances, have been granted, either as an incentive or to compensate for some other factor in the economy. In this latter case, denial of tax credits on dividends effectively cancels the incentives which are granted, and in the other cases I have mentioned there seems to be no reason for imposing additional tax at the shareholder level.

The effect of restricting credits to underlying taxes actually paid is not particularly significant for the non-resident who operates through a wholly owned subsidiary, because the only additional Canadian tax that he pays is the 15 per cent withholding tax, which is unaffected by these considerations. However, a non-resident who holds his interest in a Canadian company through one or more other Canadian companies will be subjected to additional tax on any dividend income flowing through the underlying companies if the dividends do not carry credit for underlying tax.

In our brief we explain in detail why the type of corporate structure adopted by Rio Tinto-Zinc is both necessary and desirable where Canadian shareholders participate in companies in which a United Kingdom corporation has invested.

In the case of Rio Tinto-Zinc's Canadian investments, dividends which do not carry creditable tax will arise, first where the income is derived from Churchill Falls Corporation, a public utility; secondly, a company like Rio Algom with extensive foreign subsidiaries will not pay tax on dividend income from controlled subsidiaries in treaty countries. This income will, of course, have borne the foreign tax, but no credit will be available when passed out to Canadian corporate shareholders. Income which does not carry creditable tax will also arise in Rio Algom and its various subsidiaries by virtue of depletion allowances, and in both Rio Algo and Brinco by virtue of tax deferred due to capital cost write-offs.

Quite apart from these problems, even where full underlying tax is paid, additional tax will be paid whenever dividends are paid by Brinco or Rio Algom to closely held Canadian companies which are a necessary part of Rio Tinto-Zinc's Canadian corporate structure.

The effect of these problems on Rio Tinto-Zinc is very marked indeed. In Schedule VI to our brief we have analysed the effect upon income arising from Rio Algom's interest in the new Lornex mining venture.

In Schedule VII we have analysed the effect on income arising from Churchill Falls (Labrador) Corporation. It will be seen from these schedules that the effective rate of Canadian tax in the case of earnings derived from Churchill Falls will increase to between 70 to 75 per cent, and in the case of income derived from Lornex to between 65 and 79 per cent.

Many of the other problems to which we have referred in our brief, such as the five-year revaluation for capital gains tax purposes, capital gains on corporate reorganizations and the proposed two-and-a-half year staledating of creditable tax, would not pose problems for Rio-Tinto-Zinc if it had carried out its operations in Canada through a wholly-owned subsidiary.

Considering that the Government, in section 1.46 of the introduction and summary of the White Paper, stated that relatively little change is proposed in the structure of taxes proposed on the Canadian income of people and corporations in other countries, we find it hard to believe that the Government could have intended that an organization such as Rio Tinto-Zinc Corporation should be subject to the very substantial tax penalties which would be imposed by virtue of the corporate structure through which it has made its Canadian investments. It occurred to us that the Government might have anticipated that companies such as Rio Tinto-Zinc Corporation would be able to reorganize their corporate structures in such a way as to put themselves in the same position as a non-resident who had invested in a wholly owned Canadian subsidiary.

I do not think I need go into this question in detail at this time, but we do point out in our brief that such reorganizations would be quite impractical and that even if they could be accomplished the type of structures which would emerge would be undesirable from the standpoint of Canadian investors.

We have made a considerable effort to discover a method for overcoming what we think must have been the unintended results of the integration proposals insofar as they affect foreign investments in Canada through corporate structures such as Rio Tinto-Zinc's. We considered the possibility of suggesting an extension of some kind of unilateral partnership option to majority holders of widely-held corporations, but we found this raised considerable difficulties in the treatment of losses. In the final result we came to the conclusion that the only practical way of overcoming the inter-corporate dividend problem is to retain the system of exempting inter-corporate dividends from tax.

So far as five-year revaluations are concerned, the effect of capital gains on reorganizations and the staledating of tax credits, I would simply at this stage, point out that many of the problems which have already been pointed out to your committee by others in respect of resident investors are even more serious in their effect upon the non-resident investors. These problems are, of course, dealt with in more detail in our brief.

In conclusion, we submit that non-resident investors who have chosen to invest in Canada through corporate structures comparable to that adopted by Rio Tinto-Zinc Corporation should suffer no heavier burden of taxation than non-resident investors who have invested and carry on business through wholly-owned Canadian subsidiaries. This suggestion involves nothing more than the application of the principle of fairness enunciated by the authors of the White Paper when they stated that "people in similar circumstances should carry similar shares of the tax load." It would seem to us that it is even more important to apply this principle to the treatment of non-residents where they have encouraged Canadian participation in their Canadian investments.

That, concludes my opening remarks. We would be pleased to do our best to answer any questions which your committee may wish to put to us.

The Chairman: We have already had substantial submissions in regard to most of the points which you have raised. I am interested though when you say that part of the problem would be corrected if inter-corporate dividends continued to be exempt. What are the other problems?

Mr. MacDonell: The other problems we refer to would be the five-year revaluation and capital gains.

The Chairman: You do not need to spend much time on that.

Mr. MacDonell: The answer to that is obvious.

The Chairman: You are against it.

Mr. MacDonell: That is correct. From corporate reorganizations, so far as the capital gains effect on those are concerned, we think there should be very much broader provisions for tax-free reorganization to allow legitimate consolidation for legitimate business purposes.

The Chairman: Is a legitimate purpose the test you are suggesting?

Mr. MacDonell: That is the purpose adopted in the United States under these circumstances. There has been also a broad discretion in the United States. Mr. Lawlor could comment on the United Kingdom in that respect. There are quite broad statutory provisions, are there not?

Mr. P. Lawlor, Manager, Taxation Department, Rio Tinto-Zinc Corporation: Yes, there are.

Mr. MacDonell: They are much broader than anything proposed in the White Paper.

The Chairman: What are they?

Mr. MacDonell: Finally, there is the question of staledating of tax credits which has a very strange effect when you consider the non-residents. If the non-resident is a direct investor in Canadian investments he is not affected by staledating because under the White Paper he gets no credit for taxes paid in the foreign jurisdiction. The fact that Canada may stale-date the taxed by two and a half years does not affect him. He is governed by the foreign country.

The Chairman: If he pays taxes, I presume he gets an offset.

Mr. MacDonell: I do not know whether it is two-and-a-half years or not. The interesting thing is that if you had a majority of foreign companies which did not care about staledating, they may then be in conflict with the Canadian investors to whom the staledating is vital. In other words, the payment of a stock dividend to give credit within the two-and-a-half years is vital. The only way the non-resident who is a controlling shareholder can accommodate the legitimate desires of Canadian shareholders is to either pay out all his income currently, and in this case he would be short of capital, or declare stock dividends, which could possibly involve incurring a foreign tax he would not otherwise incur. You have a substantial conflict there.

Mr. Lawlor: There is a point in regard to dividends. It is not clear as to how it would be treated in the United Kingdom. I do not know whether this would be treated as income against which you set the Canadian tax or more probably as a capital receipt. If it is treated as a capital receipt you will of course get no charge on tax in the United Kingdom, but the cost

base of your shares remains where it is. This is not dealt with as it is under the White Paper here, where the stock dividend is added to the cost base there by reducing you capital gains when you sell your shares.

The Chairman: It occurred to me, Mr. MacDonell, that there is a problem here in the two-and-a-half year limitation on your ability to rear it. How are you going to have the various compartments labelled—first year, second year and another half year? If I accumulate surpluses by not paying all my earnings in each of these years and then I pay dividends as to part of those earnings and some of the recipients of the dividends are entitled to creditable tax and some of them are not, they may be non-residents, and there is an accumulation of creditable tax. It does not increase the amount of creditable tax, I take it, that is going to the person who qualifies by reason of his dividend, because there are fewer than the total number of shareholders entitled. The White Paper leaves it blank as to how you accumulate creditable tax and as to how you label the moneys that are going to be subject to the two-and-a-half year limitation.

Mr. MacDonell: I understand that yesterday there was considerable discussion on this particular point.

The Chairman: There was.

Mr. Macdonell: I cannot but agree with you that it poses a tremendous problem, particularly when you think of the additional problems in dealing with different classes of shareholders.

The Chairman: Yes.

Mr. MacDonell: It is a very hard thing, in fact, to label which income is entitled to creditable tax and which is not.

The Chairman: If the White Paper proposals are implemented in this regard, whatever accumulation you have at that starting point, is that put on one side and is not subject to the two and a half year limitation?

Mr. Macdonell: I do not know the answer to that.

The Chairman: The White Paper does not give any answer.

Senator Cook: I wonder what happens if you start making a big loss in the third year. If you made profits for two years and then in the third year the board of

directors met and found that they would declare a loss and as they could not pay a dividend out of profit they pay it out of capital or something else.

The Chairman: It is a good question and the White Paper does not answer it. You might normally say that if they make a loss they write it off against the surplus. I am not sure whether they are not allocating each year in such a water-tight compartment that that may not be the way in which it would be treated.

Mr. J. C. Wilson, Chartered Accountant, Rio Tinto-Zinc Corporation: In dealing with the loss question, if the loss were carried back to previous year's profit, which was open to you, it would reduce the tax for that year and of course reduce the creditable tax to that extent, so there would be some offset. But if in fact it was carried forward against future years you would have to wait for the production of profits before you could get a reduction of tax.

The Chairman: Does the shareholder who has received a dividend and had advice from the company as to what his creditable tax is, and he takes it, and then when he carries the loss back, that upsets the whole calculation. Now, what is the position? The White Paper does not say what is the position.

Mr. Wilson: This is quite true, there is a complication in taking the loss back, because you may have dealt with your profits in terms of dividend at that time. And the rules change. I am afraid the Government is the only one who can give us a clear answer to that.

The Chairman: We are trying to get some clear answers, if it is humanly possible, I can tell you that. We have had a great deal of evidence from mining companies in connection with the incentive. We do not have to argue whether there should be incentive, the White Paper concedes that, but they just say they are too great. We have had one suggestion that they have been toying with, and that is that there might be what are called abuses in the use of the tax holiday by not writing off any expenses in that period and carrying them on afterwards, bringing forward your pre-production expenses, and the net result may be an effective tax holiday on six or seven years.

We have had evidence to indicate some large companies in mining operations with substantial income, who have gone as far as seven years of operations before they began to pay any income tax.

The suggestion we have had is that we should not do away with the tax holiday such as the White Paper suggests but that there be some determined percentage, whether on an amortization basis in relation to the money that you have borrowed to create this enterprise, and a percentage should be written off against that tax free income in that period; or deducted from the total of your pre-production expenses. You would still have a substantial part of the income that you earned, but it would cut down the period of enjoyment after the end of the tax holiday, where you enjoy an effective continuance of the tax holiday. Have you any comment on that?

Mr. MacDonell: I do not know that there is any question that limiting the write-off would overcome one of the abuses of the three-year tax free periods—and I am not sure that "abuse" is the right word. I should think the write-offs have been greater since the Supreme Court of Canada decision in which they allowed the separating element to come into effect. They allow some exploration expenses to be carried forward which might otherwise have been considered expenses of operation.

The Chairman: On the question of depletion, we have been told by some of the mining companies that if they had to make a choice between a tax holiday and depletion they would opt in favour of depletion. The White Paper of course ties it in to exploration and development. What comment have you to make on that?

Mr. MacDonell: I would like to comment on that. I mentioned this earlier. I think one of the things that comes out of these proposals is that they fail to acknowledge that a very high level of taxation is imposed by the provinces on this selective industry, the mining industry.

Most of the figures in the main submissions we have received show that the combined level of tax in fact is considerably higher than the combined level of taxes federal and provincial that are suffered by other industries. One cannot really say that earned depletion suggestion is an incentive. At its best, it probably brings the mining company back, overall, to a comparable position to other investments.

The Chairman: The dollar you would get for spending \$3 might be said to be a bonus.

Mr. MacDonald: Yes, it might be, if you were not suffering substantially greater taxes anyway.

The Chairman: Yes.

Mr. MacDonald: On the question of depletion, I would suggest that the depletion incentive suggested does not really do the job. It should bring the overall level of taxation down to something less than other industries if in fact it is to be an incentive to invest in this very high risk industry.

The Chairman: I think that is logical. What you are saying is that, overall—which is the only way you can look at it—there is not any incentive if you are going to end up paying the same corporate tax rate.

Mr. MacDonald: That is exactly it.

The Chairman: We have had a suggestion here that because there are some mining companies that cannot earn depletion—take, for instance, the iron ore development, they know where the iron ore is, and they know they have a hundred years' supply—it seems an idle sort of thing to go out and think in terms, certainly immediately, of spending money on exploration and development. Roughly speaking, they are in the position where they cannot earn depletion; but is that a reason for denying them depletion. The White Paper does not say that depletion is a bad thing, they just say that you get too much of it. So we must accept the principle of depletion.

Mr. Mulholland: Does it not depend on what it is you are trying to encourage?

The Chairman: That is right.

Mr. Mulholland: If you are trying to encourage mining and development, I would think it is quite a good point.

The Chairman: That is right. The suggestion we have had here, in order to take care of all the variables that you have in the mining industry. There is a variable in the iron ore industry, and I believe the tar sands operation is considered to be a mining operation. They are not in a position earn depletion, other than by exploration and development. That is not the problem. They know where the sands are and they know what they have to do to be productive.

The suggestion we have had is that you should divide the depletion allowance as between depletion to which

you are entitled in any event and earned depletion. And maybe the earned depletion would be put on a basis of \$1 for every \$2 you spent, with a limitation of one-third of your net production income, although some have suggested on the gross. But the 20 per cent that you would be entitled to in any event should be on the gross production income. Roughly speaking, by that division you would about reach the present 33 1/3 per cent depletion allowance if you went out and spent up to the hilt what you are permitted in earned depletion as well as the 20 per cent, but at least you would have the 20 per cent on the gross. Do you think there is some merit in that kind of approach?

Mr. MacDonald: Well, I have not considered that particular suggestion in detail, but it does seem to me that there are two things that are meritorious about it. The "as of right depletion" really recognizes the higher taxation in industry because it thereby allows the balance of earned depletion to really act as an incentive. I would have to make one comment upon that, and that is really the one which you referred to earlier, and that is that the base to which earned depletion applies should be very much broader because surely, as Mr. Mulholland pointed out, the incentive must be to develop more and more efficient ore. It would seem ridiculous if the incentives were to be for new mines only so that your base for new mines was higher and you could develop less economic new mines rather than increase production from an existing mine. It also seems to me that the depletion for the mining industry is really not the same thing as for the oil industry, except for the tar sands, because in the oil industry, you have certain proven acreage and to increase your production, you step out and drill wells where you know you will get production.

Now, until you get production, assuming that is a new facility, you have a much wider base for your depletion. I think a comparable situation to that is something like the iron ore company when it develops greater parts of its deposits and since that increases production, there does not seem to be any logical reason why they should not get those initial expenses in the iron ore industry as a base.

The Chairman: I liked the statement you made earlier. I think it should be logically the starting point for any consideration of incentives, whether mining or oil. That is, what is the effect of it? Can it be an incentive if you end up paying the same taxes as everybody else? Because I judge that the interpretation or connotation of incentive means that you are being given a concession because of the extraordinary risks that are attached, and the only way in which you

can really recognize an incentive is if you pay less tax. In other words, you are allowed to retain a larger percentage of the earnings that you produce.

I think that perhaps we have pushed that one around a lot, and I don't think there is anything more you can add. I take it that on the question of integration you are opposed to the proposals contained in the White Paper. Is that a fair assumption?

Mr. Mulholland: That is a fair assumption.

The Chairman: And you would favour the dividend tax credit?

Mr. MacDonald: I think that is correct.

The Chairman: Even if some limitations were found to be necessary on the basis that the dividend tax credit was earned whether the corporation paying the dividend has paid taxes or not.

Mr. MacDonald: I think that is true, and I think as I pointed out earlier that when you look to the underlying reasons for a corporation's not paying tax, you realize that in many cases it really has in effect paid taxes or has technically paid taxes.

Mr. Mulholland: Senator, you made a point a little while ago about confusion between collecting funds and disbursing funds in connection with the Public Utilities Income Tax Transfer Act.

Senator Carter: Would the witness speak up louder, please, it is impossible to hear.

Mr. Mulholland: You can have the same kind of confusion when you are talking about depreciation, capital cost allowances and incentives. There is no sense in granting an incentive with one hand and taking it back with the other.

The Chairman: That is right. That criticism would apply particularly to the integration proposals.

Mr. Mulholland: So. I am making this remark apropos your statement on taxes and whether or not the company paid taxes; if the reason that it did not pay taxes was because of incentives such as capital cost allowances, tax free holiday or depletion or something like that. But why should the credit not stand? In granting that incentive, you are trying to do something quite different, and if in trying to get that company to do something, you are not trying to deter the investor from investing.

The Chairman: Well, the Government follows that principle somewhat in the depressed area provisions where in some cases you get capital grants and you can include them in your assets for depreciation purposes when you put them into buildings, etc. So this is one case where you are not hurt. I mean by that that you get full benefit of what you have produced in the way of buildings no matter where the money came from, whereas you did have under our area designation legislation entitlement in some circumstances to a tax holiday period. So it would not appear that it could be said that the tax holiday is morally bad. The White Paper seems to spurn it on the basis that it is morally bad to have such a thing.

Mr. Mulholland: There is a strong undercurrent of feeling that it is a fundamentally right thing that there should be a tax credit only depending on what tax situation the company was in that paid the dividend, and in fact due to some other Government programs of incentives, if it did not, and the money was disbursed in some other way, the credit should not follow. I am afraid I cannot go along with that reasoning at all any more than if the Government happened to tax the company and the funds were spent on, let us say, welfare payments and schools and yet you had a provision in the law that said that if a company's taxes were spent on schools, there would not be a credit. To me it doesn't make much sense.

The Chairman: I think you have a point there. In other words, it is not a sufficient answer, in order to reject a dividend tax credit method, to say "yes, but some shareholders will get money that has not been through the wringer of taxation".

Mr. Mulholland: That is one of these superficially plausible things that if you do not think about it sounds all right, but if you happen to consider it, and start to take it apart, you begin to wonder if it is one of the fundamental truths after all or if it is something that is just a *non sequitur*. I happen to think that it is.

The Chairman: There are many *non sequiturs* in the White Paper, even on the question of creditable tax.

Senator Carter: In your brief you say you are preparing the development of a copper mine at Deer Lake. Will the tax proposals affect the continuation of that development, or will you postpone it?

Mr. Mulholland: I do not think I can give you an answer, because I do not have one. We have to do more work to see how critical the economics are.

Conceivably, they could make it a marginal question. On the other hand, it may turn out that it makes it less attractive than it would otherwise have been, but not sufficiently less attractive to deter you. The answer to that I do not have, because we do not have enough work done to have the information we need to make a decision on it.

Senator Carter: Are there any other plans for development that you have in Canada being deferred because of the White Paper proposals?

Mr. Mulholland: The Gull Island project is unquestionably going to be a case in point. That has gone to the point now where all the basic field work, the drilling for foundation and soil conditions, the conceptual design work and all that has been done, and you come to the point where you have to think seriously about the commercial aspects—taxation, financing, terms of sale of power, and so on and so forth—and the White Paper proposals bulk very large in that. It is very obvious they make it much less attractive and much more difficult to do, if not impossible.

Senator Carter: I was thinking more of mining development rather than power.

Mr. Mulholland: The other things we are working on are not at that critical stage of decision now.

The Chairman: It is quite obvious there is another factor you have to add in, your feasibility studies.

Mr. Mulholland: One of the things that escapes notice is that you never know, when you enact something like this, just how many projects did not get going, and you do not know the true cost of it. It is one of those things that is just lost. It is like not knowing how many children were not born because of something.

The Chairman: It is like the system they have in the courts in estate matters of appointing someone to represent the unborn children. They may never be born.

Senator Carter: This tax agreement you have with the Newfoundland Government, whereby they rebate to the utility company what they get from the federal Government in excess of 22-1/2 per cent of your taxable income, is there a time limit on that agreement? Is that for a fixed period?

Mr. Mulholland: Yes, as long as the basic power contract is in effect.

Senator Carter: So it is for the 40-year period?

Mr. Mulholland: That is correct.

Senator Carter: Will the White Paper proposals put you in a position where you will have to renegotiate it with the Newfoundland Government?

Mr. Mulholland: It takes two to renegotiate it. I am afraid I cannot speak for the Newfoundland Government; they may not want to.

Senator Carter: But do you anticipate that you might have to seek to renegotiate it?

The Chairman: You mean that it may be a proper subject for renegotiation?

Senator Carter: Yes.

Mr. Mulholland: I think, senator, going back to the reason for this in the first place, which was a fundamental question as to whether or not the federal Government should tax indirectly what it would not for a moment suggest it should tax directly—that is, the production of power and if it were produced by a crown corporation you would not tax it or would not build it into the public's power rates—Quebec's position was: Well, why should it be in the power rates to the public just because it happens to be over the provincial line in Newfoundland and it is a private company? That is a very good question. It was felt by the federal Government that that was, indeed, a good question, and it had come up in a number of other places besides this particular one, and the whole intent of this was to eliminate federal taxation as a competitive factor in power projects so that you could simply take your choice of how you wanted to do it.

When you talk about renegotiating this contract, you cannot talk about it without talking about whether or not you are willing to accept either an alteration in power rates, which is something that the Province of Quebec is probably not going to be very pleased about, or a reduction in the revenue to the Province of Newfoundland, whose claim is just as strong as that of the Province of Quebec.

Senator Carter: This money coming to you from the provincial government, if it goes from Churchill Falls Power Company to Brinco, is that taxable again under the White Paper Proposals?

Mr. Macdonell: It is difficult to see this point, but when you recognize that the power price to Hydro

Quebec was reduced to reflect the rebates, you have to then look at it this way, that if there had been no rebate from Newfoundland you would have had to charge a price for power which would, after taking effect of the tax, have given a return to investors which was sufficient to attract the equity involved. So the figures would not be exactly the same, but what would be true is that if you had done it that way your income after taxation would have tax attached to it which would give fully creditable tax, but because you have had a reduction in power price and you have a rebate which is technically tax free, when that is distributed out it becomes taxable in the shareholders' hands.

The Chairman: With no creditable tax.

Mr. Macdonell: With no creditable tax. So, you have a situation where effectively it has been taxed. It has been taxed in the sense that the full amount has been reflected in the power price, but that does not show up in the accounts as taxed. What shows up in your accounts is, in fact, a rebate from the Newfoundland Government, which is taxed again.

Senator Carter: If it goes from Brinco, as a subsidiary, to the parent company, before it goes out to shareholders at all, is it taxable? Is that part of the transaction taxable under the White Paper proposals?

Mr. Mulholland: The White Paper is not clear on it, and in our talks with the officials we have been given to understand it was not the intent to make it taxable. On the other hand, as Mr. Macdonell pointed out, it would not carry creditable tax, so there is, in effect, an obverse side to this. Really, the ironic thing about it is that none of this money goes to the company and, in fact, we lose a little money because the agreements were all worked out on the basis of the minister's statement before detailed legislation, and it was assumed it would be 100 per cent rebate and not 95 per cent. So, acting as the mechanism, we actually got charged some money out of our own pockets, and of course, we have the money tied up for 18 months, or something like that, which is also a cost to the company. We did not want to do it in the first place, but we did it as an accommodation to the two provinces. We do not have any economic interest in it one way or the other. The money just goes right through us. So, for reasons I will not go into here, the provinces did not care to deal with this matter directly, so we agreed that we would provide the mechanism, and now this has caused all sorts of problems.

Senator Cook: With regard to the Gulf Island project which will probably be deferred, you feel there is a market for that power, do you?

Mr. Mulholland: Yes, senator, there is a growing shortage of power. It is apparently tending to get worse all the time, and I would think that barring some very drastic change in the economic expectations—a recession or something, which I trust we do not have—this is going to become a more acute problem all the time.

Senator Cook: Then, stating it positively, the development of the Gull Island power project will help further industrial development in the rest of Canada.

Mr. Mulholland: Sure; it always does.

The Chairman: Then, Mr. Mulholland, do you think we have hit the high points of your submission? You know, of course, that we have heard most of the mining companies, and we have received a great deal of information and opinion and, in the process, we have received some education. I might even say that we have formulated some ideas which in due course may appear when we arrive at the stage of writing a report.

On behalf of the committee, I thank you for the useful information you have given us, I assure you that we will make use of it.

Mr. Mulholland: Thank you, Mr. Chairman.

The Chairman: We have two other submissions to consider today, and I suggest that we adjourn until 2.15 this afternoon, and deal with them, at that time.

The committee adjourned.

—Upon resuming at 2.15 p.m.

Senator Douglas D. Everett (*Acting Chairman*) in the Chair.

The Acting Chairman: I will call the meeting to order.

Honourable senators, we have a brief to consider from the Electronic Industries Association of Canada. Representing that Association we have with us Mr. Longstaffe on my immediate right, Mr. Sheperd, the Hon. Leon Balcer and Mr. McAlpine.

Mr. Longstaffe, if you would like to start with an opening statement or have one of your colleagues do so, it would be most satisfactory to the committee.

Mr. R. Longstaffe, Vice-Chairman, Electronic Industries Association Of Canada: Thank you very much, Mr. Chairman. Before discussing the details of our brief I would like to spend a few minutes talking about the Electronic Industries Association of Canada and the various problems currently confronting the Association.

The Electronic Industries Association of Canada is a trade association of Canadian manufacturers of electronic equipment and components. This industry is made up of three major segments.

Number one is the consumer products manufacturers who manufacture television sets, record players, tape recorders and other items of consumer products.

The second area is the electronic equipment manufacturers, who manufacture communications, broadcasting and navigational equipment, computers and various electronic systems.

The third group is the component manufacturers, who make such items as resistors, capacitors, transformers and integrated circuits. These provide the building blocks for the two other segments of the industry.

The electronics industry in Canada is rapidly growing and is now a substantial industry in this country. In 1969 our factory shipments were over \$1 billion. Of this, some \$300 million worth of our products were exported. This industry now employs approximately 65,000 people. Our industry will provide the equipment that will enable Canada to move from the industrial age to the post-industrial society of the future. It will provide the technology and equipment to create the "wired city" and, indeed, the "wired nation" for the benefit of all Canadians.

For example, the two prime contractors on the Telesat Canada program are both members of our Association. They are Northern Electric, who are building the ground stations and RCA building the satellite, or the bird.

However, our industry presently is faced with many problems which I would like to touch on briefly.

Number one is the continuing discriminatory 15 per cent excise tax on television sets, which favours

importers and makes it more difficult for our Canadian-made product to compete for the consumer dollar in the Canadian market.

Secondly is the unilateral reduction of tariffs under the Kennedy Round, which occurred in 1969. This made it more difficult for us to compete in our own Canadian market.

More recent developments include the unpegging of the dollar, which in addition to making foreign products cheaper in our market, has also resulted in serious problems for those companies currently holding export contracts priced in U.S. dollars.

An example of this is that the average profit after tax last year for our industry was approximately 3 per cent. Certainly a 5 per cent to 6 per cent increase in a value of the dollar will virtually wipe out any possibility of profit in the existing contracts.

Another area is the continuing freeze on radio relay licences, which has resulted in substantial lay-offs of staff by our communications equipment manufacturers.

A continuing problem is the rising flood of low cost imports, which now accounts for some 40 per cent of total Canadian electronics consumption and is forcing Canadian manufacturers to reduce or close their operations.

A recent example of this is the decision made by the Canadian General Electric Company to close their facilities in Toronto for the manufacture of receiving tubes and colour picture tubes.

There is within our industry a continuing need for increased research and development funds to be spent in industry, rather than on Government facilities, in order to support the high rate of technological change and keep Canada in the front ranks of the industrial nations of the world.

These are some of the many problems concerning us. Any moves by the Government to provide further disincentives to our industry by the proposed tax changes is of great concern to us.

I would like to call upon the chairman of our tax committee, Mr. Dave Sheperd, to discuss the key points of our brief.

Mr. D. Sheperd, Chairman, Tax Committee, Electronic Industries Association of Canada: Mr. Chairman, in the preparation of our brief we have been

primarily concerned with the freedom of the individual and his movement. Further, the preservation of free enterprise. We have voiced concern with the growth of the public sector versus the private sector.

However, no numbers in our brief should be considered absolute, rather, to establish an order of magnitude—to be reviewed.

Our industry is growth oriented and subject to rapid obsolescence. We need high returns because of this factor.

Nonetheless we realize our obligation to promote social welfare and have in particular submitted a unique proposal in item 1 (b) (i). The other items are primarily designed to encourage this country to develop a world competitive electronics industry.

With that we would like to open the hearing to the group of senators for questions and discussion.

The Acting Chairman: Do you have anything to say, Mr. Balcer?

Hon. L. Balcer, President, Electronic Industries Association of Canada: No. I will be pleased to answer questions.

The Acting Chairman: Honourable senators, since the brief is a short one, with your agreement we will go through it item by item. Would you deal with item 1, please?

Mr. Sheperd: We have stated particularly in item 1 a concern with the growth rate of the gross national product and the public sector of the gross national product.

We realize at this point that it is at one-third. We have listened to the argument particularly put forth by the Treasurer of the Province of Ontario, that the White Paper tends to promote creep within the public sector.

We have suggested that a limit of 25 per cent be established. As I mentioned in my opening remarks, the 25 per cent is not an absolute figure, but rather an order of magnitude figure.

The Acting Chairman: What did you say it tended to establish in the public sector?

Mr. Sheperd: Creep the growth rate upwards. In other words, you tend to get a little more percentage going into the public sector than was there the year before.

The Acting Chairman: And you term that creep?

Mr. Sheperd: That is what we call creep, yes.

The Acting Chairman: That is interesting.

Mr. Longstaffe: The other area with which we concerned ourselves somewhat was the factor of the percentage of funds to be commuted for future expenditure. We picked the number of 40 per cent. We felt that if the remaining 60 per cent were left free this would allow governments, both at provincial and federal levels, sufficient funds to accomplish the objectives which were set out within the budgets on an annual basis.

Senator Isnor: What do you mean by that 60 and 40?

Mr. Sheperd: Not over 40 per cent of the funds would be committed to major projects which have a continuing impact in future years. Let me give you an example. The St. Lawrence Seaway was a long-term project of the Government, and therefore funds were committed for future years. We feel this should be held to 40 per cent of the earnings of a future yearly income.

Senator Carter: Are you including statutory payments in that?

Mr. Sheperd: Yes sir.

Senator Carter: Has the Government committed itself to salary increases or Old Age Pensions? Are any increases included in that 40 per cent?

Mr. Sheperd: Right. We are saying that the country has a growth factor. As the country grows, so does the percentage allocated to the public sector, and therefore the percentage allocated to future expenditures will grow.

Senator Carter: You are premising it on the same reasoning that the pulp and paper industry gave. Were you here this morning?

Mr. Sheperd: Only for the Brinco brief.

Senator Carter: Mr. Fowler advanced that idea in a different way. It seemed to me that it was predicated on the idea that the growth in the economy is going to keep up with the increase in the expenditures. That means these two must be kept in balance. Is that what you are saying?

Mr. Sheperd: Yes, sir.

Senator Carter: In other words, the increase in expenditures in any one year is limited to the forecast increase in revenue?

Mr. Sheperd: Correct.

The Acting Chairman: You are saying that only 25 per cent of the gross national product should accrue to all governments as revenue?

Mr. Sheperd: That order of magnitude, yes, sir. We realize it is 33 per cent now and we are not going to argue with that figure. We felt this had gone far enough so we picked a number below 33 rather than above.

The Acting Chairman: Of that 25 per cent, 60 per cent goes into present uses?

Mr. Sheperd: Current expenses, correct.

The Acting Chairman: Under our present budget which, as you say, is 33 per cent of the gross national product, 73 per cent goes into statutory expenditures. I am talking specifically of the federal budget here, over which the federal Government has almost no control at all. Do you think your scheme is really feasible?

Mr. Sheperd: In the statistics we are using, which may not be up to date, we were looking at total government expenditures, not just federal, and segments devoted to statutory expenses. We were led to believe this number was 40 per cent.

The Acting Chairman: What are the other 60 per cent?

Mr. Sheperd: They were current expenses.

The Acting Chairman: You are talking about growth expenditures. Is this another form of expenditure? I think you likened a growth expenditure to the sort of investment expenditure in the St. Lawrence Seaway.

Mr. Sheperd: That is not quite what we had in mind. When we started looking at the area of total expense we sort of broke it down into two areas, one which was a statutory on-going expense. On-going expenses are those things which you commit today but which must be spent tomorrow. They are current expenditures.

When we come to the growth segment of our brief, we are more inclined to want to talk about incentives which would be applicable to our industry or other industries for the growth area. We would consider the EIAC a growth type of expenditure.

Senator Carter: One step further. You intimate here that you are going to reduce from the present 33 per cent of GNP down to 25. Further down you say that industry or the private sector should take over some of the Government's responsibilities for welfare.

Mr. Sheperd: Yes, sir, that is one of the ways we might get this down. This is not a new idea. If you look to the Far East you will find that the Japanese have a very interesting philosophy in the treatment of their employees in industry. When an individual goes to work in a Japanese corporation he is generally there for life. Both the corporation and the individual recognize this. We have some recent legislation proposed in the Province of Ontario which says we must give advance notice of lay-offs. This came up within the last week.

What we are trying to suggest is that industry has the responsibility for the welfare of people, and the more we put the onus on industry the more that industry will think about the utilization of those people. In our industry we have taken a page out of the Japanese book where they have been so particularly successful in the field of electronics, and we have said how have they done it. We think they have gained quality and service through a very coherent organization within a company and within the industry.

This is the kind of idea we are trying to develop here.

Senator Carter: I would like to get some idea just what specific responsibility you would take over from the federal Government. Would you take over pensions, for example?

Mr. Sheperd: There is an area in pensions that we could take over, but we are thinking more specifically in the area of unemployment, that lay-offs would not be as frequent as they are today.

Senator Carter: I thought the electronics industry was one that was going to put more people out of work.

Mr. Sheperd: I would hope, sir, that our industry would create opportunity for many more jobs. Unfortunately, we seem to be the ones who are putting people out of work these days in our industry.

Senator Carter: What about cybernetics automation? That is a part of your electronics industry, is it not?

Mr. Sheperd: That is a term with which we are not familiar.

The Acting Chairman: Would you like to define cybernetics?

Senator Carter: As I understand it, cybernetics is where you replace brain with electronic circuits.

Hon. Mr. Balcer: I may say that in our association we have computer companies. At the present time they are carrying on considerable research and development in the fields of lasers, satellites, and so on. We are confident that we can render tremendous services to Canada in the years to come, and that by the year 2000 this country will probably have as its most important industry, as far as employment is concerned, electronic-producing and contributory industries.

Electronics is a very important industry, and we feel very confident that 30 years from now it will have pervaded the whole of Canada. For this we need recognition by the Government of Canada, and by its parliamentarians, of the importance of the industry. That is why we are before you today to discuss the White Paper, and also other government actions and legislation which we feel can be harmful to our development, such as the 15 per cent excise tax, which taxes electronics at the same level as jewels and perfume. It is an old tax that was established during the last war and we are about the only field where such a tax still exists. We feel that, if Canada is determined to be one of the leading industrial nations in the world, it would be a very progressive move if the Minister of Finance could relieve us of this 15 per cent excise tax, which puts Canada in a pretty weak position compared with the United States and Japan and other highly industrialized countries. So I think we are very confident that our industry can produce a lot of jobs and create employment. But we need also the support of the Canadian Government.

The Acting Chairman: Thank you Mr. Balcer.

Senator Benidickson: You refer to the 15 per cent special rate of consumer tax, which was passed on?

Hon. Mr. Balcer: Yes.

Senator Benidickson: I had some sympathy with that. It is not in your brief but I am glad it was in your remarks. I did not quite understand how that increased the pressures from competition outside of Canada. If one were to import a piece of electronic equipment, say a television set, would that import not be subject to a 15 per cent tax as well as the normal sales tax?

Hon. Mr. Balcer: That is right, but this 15 per cent tax is on imported goods. It is levied at the moment it comes into Canada, at distributor's level. As far as the Canadian product is concerned the tax is levied at the dealers' level, which gives a certain percentage advantage to the imported goods. Also, it puts a Canadian industry in this position, that whenever a Canadian goes to the United States or reads *Life* magazine or *Time* magazine and sees these advertisements for television sets at such and such prices and looks at the prices of Canadian television sets, he sees that the Canadian one is away up high. This creates a feeling that our industries are inefficient or something like that. This is very damaging for the image of our industry.

The Acting Chairman: Does that answer your question?

Senator Benidickson: For the import price—take Japan, the levying of the excise tax would be the wholesale price to the importer . . .

Hon. Mr. Balcer: That is right.

Senator Benidickson: . . . plus freight? Is there an imposition of tax on freight?

Hon. Mr. Balcer: I understand that it is levied when it is delivered to the importer. As far as the Canadian product is concerned, it is levied at the dealers' level.

Senator Benidickson: Is it on the price from the wholesaler to the dealer?

Hon. Mr. Balcer: Yes. Also, on top of that, with the unpegging of the dollar, we have another disadvantage, on account of the differential. Also, there is a percentage on the tax levied which is lower for imported goods compared with ours.

The Acting Chairman: Perhaps we can come back to the White Paper. Are there any further questions on item number 1, honourable senators?

Senator Benidickson: Mr. Chairman, I did not want to get into an argument about this. As you say, it is not just directly tied in with the White Paper. However, the Treasurer of Ontario was quoted, I think, in the remarks. I do not know whether our visitors realize that in recent years the percentage of tax taken by the federal Government has been going down and the percentage of tax take out of gross national product has been increasing for all governments and has been largely attributable, with good cause, to the take that is required by the provincial governments because of the rising demands of the things within their responsibility, such as education, health, welfare and matters of that kind. Actually, in the federal sector our percentage of take here from the GNP for several years has been going down.

The Acting Chairman: What you say, Senator Benidickson, is quite right, I think they are referring, though, to the total Government expenditure, that is, Government at all three levels.

Senator Benidickson: Yes, but actually we have been making rules in recent years and are not really responsible for the increase shown in the last few years out of the overall GNP.

The Acting Chairman: That is a good point.

Senator Carter: What bothers me about the 25 per cent is that the federal Government has not too much control over the provincial expenditures, the provincial share. What are you going to do? Let the federal take its bite first and then let the others do so?

Mr. Sheperd: I do not think that we, as an industry, are prepared to get into that discussion.

Senator Kinley: Do you make television sets in Canada?

Mr. Longstaffe: Yes, sir.

Senator Kinley: Clairtone, in Nova Scotia?

Mr. Longstaffe: Yes, sir, they are one of the members of our association.

Senator Kinley: They are one of the members of your association? How do they do it?

Mr. Longstaffe: I would prefer not to answer that question, senator.

The Acting Chairman: I think that is a very good question, Senator Kinley?

Senator Kinley: All right. I would just like to know.

The Acting Chairman: If there are no further questions on item number 1, honourable senators, perhaps we can ask the witness to proceed to item number 2.

Mr. Longstaffe: I would like to comment on this one a little further. Canada, like many other advanced nations in the world, is working extremely hard to build some strong technologically based industries, particularly in the electronics field. I am referring to the United States certainly, Japan, West Germany, just to name a few that immediately come to mind. In doing this, all of us are competing for the people, the middle management people, the technologists, the technicians, the engineers, who can bring forward this future developments. We are extremely worried under the White Paper proposals that will make it extremely difficult for us to attract this calibre of people to Canada to assist in our technological development.

The present proposals as we interpret them certainly add a greater share of the tax burden on to the so-called middle income people who are the bread and butter people of an industry such as ours.

Certainly, it would make moving to the United States or not being attracted to Canada in the first place and much more serious problem with us. We are concerned that this level of people or level of income would carry a greater share of the tax burden. I think that is all I have to comment on that item.

The Acting Chairman: Are there questions on this part? You refer to tax advantages to skilled middle-income people. What tax advantages are you referring to? Have you any specific questions in that line?

Mr. Sheperd: Let us take a rather direct one, the income tax. We find ourselves, as Mr. Longstaffe has pointed out, in competition with the United States in particular but with western European countries where people who are skilled in the field. We find in many cases that these skills are migrating from this country to others—and again particularly south—because of the advantage in their personal income at the end of the tax period. We feel that we are to be in a position to compete for this skilled life.

The Acting Chairman: What you are suggesting is tax reduction for middle income people?

Mr. Sheperd: Yes, sir.

The Acting Chairman: And further, that the principal residence be not subject to the capital gains tax and that the lower limit of personal property vis-a-vis capital gains be raised from \$500 to a much higher limit, say several thousand dollars.

Mr. Sheperd: Yes. One of the things that we run into is the high mobility of our people within the industry, because we are made up, to a great degree, of multi-national companies and the movement of people back and forth within these multi-national companies requires that there be some continuity of treatment. We would like to see the individual income tax adjusted so that there is continuity of treatment.

Senator Isnor: What percentage of your staff would be composed of so-called high-salaried, imported personnel?

Mr. Longstaffe: We have no figures on that, as such. I do not think the percentage is very high. However, it does sort of represent the cream of the crop in many areas. These are the people who are bringing in the specialized skills, either for a continuing period or, in many cases, for a relatively short period of time in order to assist the Canadian company or the Canadian operation in getting going. They may be on assignment to this country for a matter of some two or three years to assist in starting new operations in Canada, and then they go back to the States or on to western Europe to do a similar type of thing. In actual numbers I think it is relatively small, but their contribution is much greater than their actual numbers. I am afraid I have no specific figures on that.

Mr. Sheperd: 5 to 10 per cent.

Senator Kinley: Do you not represent mostly American companies? Take Honeywell, for instance, they do not manufacture in Canada, do they?

Mr. Sheperd: Yes, they have a very large factory in Toronto. The President of the Canadian Manufacturers Association is the Chairman of the Board of Honeywell.

Senator Kinley: Why do you not take on the Japanese and Germans?

Mr. Sheperd: We try hard, sir. They have a cost advantage today; their labour rates are considerably lower.

Senator Kinley: I know all about that, but it is a wonder they are not after you to take on their lines. They come to us every two or three months. They have automobiles, all the electronic equipment, consumer products.

Hon. Mr. Balcer: I think all the people listed here are manufacturing in Canada, and we manufacture practically every type of electronic equipment that exists in the world.

Senator Kinley: But your subsidiaries are American companies?

Hon. Mr. Balcer: Some of them, but others are not. Take, for instance, Northern Electric, a member of our Association. Northern Electric has in its micro-system labs here in Ottawa over 2,000 scientists working on electronics, and in the consumer field, for instance, you have Electrohome, which is a company that has a work force of about 3,000 people, which is essentially Canadian, and it is going very well. You have here Mr. Longstaffe of Renfrew Electric Company, and that is a wholly-owned and wholly-staffed Canadian industry.

Senator Kinley: The price in Canada is so much higher.

Hon. Mr. Balcer: That is why I was diverting from the White Paper to this 15 per cent in sales tax. We would like to be able to offer the same price as the U.S. are offering to their own citizens.

The Acting Chairman: Perhaps, honourable senators, we can move on to item No. 3. The statement is:

Bursaries and scholarships should be tax exempt.

We have had considerable representation on that. If you have anything further to add we will be more than pleased to hear you.

Mr. Longstaffe: No, we have no specific comment on that.

The Acting Chairman: Item 4 concerns the capital gains tax.

Senator Benidickson: You will agree with many of the presentations we have had, and you would suggest that we should not have a capital gains tax any more onerous than that perhaps of our closest competitor, the United States? You have more or less adopted here the capital gains tax base of the United States?

Mr. Longstaffe: If we must have a capital gains tax, certainly we would not want it any more onerous than the American system.

The Acting Chairman: You have heard it suggested that the succession duties be reduced to accommodate the capital gains levy, is that correct?

Mr. Longstaffe: If this were going to occur, certainly.

Mr. A.D. McAlpine, Counsellor, Electronic Industries Association: Honourable senators, I must confess I lack complete familiarity with the operations of each of the companies, say, in the components division, but Mr. Balcer can deal with that. Many of these companies are not large ones. They are Canadian companies, and the Association believes that there should be encouragement for the growth of companies and the ownership of companies in Canada rather than forcing family corporations to be disposed of to foreign ownership, be it in the U.S., the United Kingdom or whatever the case may be. The Government has in 3.2 of the White Paper recognized that there is a problem of the combined impact of the capital gains and succession duties, and the Government has suggested that when assets are transferred to the executor there should not be a capital gains tax at that time but at the time of disposal.

Senator Benidickson: The White Paper, as I understand it, in connection with the combination of succession duties and capital gains, does recognize a situation that both types of tax might be payable on death.

Mr. McAlpine: Yes, sir.

Senator Benidickson: Their proposal is not that the capital gains tax, or vice versa, be reduced because of the payment of the other tax. They simply suggest that the succession duty tax would be postponed until the assets were sold.

The Acting Chairman: No, I think that the cost of the assets in the estate is increased by the amount of the capital gain that was paid. I am sorry, it is the other way around. The value of the assets is increased for capital gains purposes by the amount of the estate tax paid.

Mr. McAlpine: I think we want to emphasize that this is a problem that has been with Canadians for many years, and the Association feels that if you have

a very high rate of capital gains tax combined with a high rate of estate tax, you will be forcing Canadians to go outside Canada, which is something we think should be discouraged.

Senator Benidickson: When you put the two together you use the word "unbearable"?

Mr. McAlpine: Yes.

The Acting Chairman: Mr. McAlpine, we have had a suggestion, in light of the recommendation that the quinquennial valuation provision be removed and the fact that the Minister of Finance has, I believe, stated that if it is removed there would have to be a deemed realization on death, that if there is such a deemed realization the amount of the capital gains tax be a credit against the estate tax at that time. In other words, there would be a single tax which would be the higher of either.

Mr. McAlpine: I think that solution has merit so long as the capital gains tax is not too high. On our basis, a maximum of 25 per cent, there would be some merit in it. If you have a 50 per cent capital gains tax, you would have a too high rate of tax for that solution to be practicable.

The Chairman: If there are no further questions, honourable senators, we will move on to item 5, which concerns the valuation and the quinquennial revaluation.

Senator Benidickson: You are not alone in making this suggestion; we have had it repeatedly. I do not think you would wish to elaborate on what is stated with respect to that.

Mr. Sheperd: There is just one comment that we might make regarding the suggestion for valuation day. That is that anyone with a capital situation be allowed one turnover without tax and that the second go around be the institution of tax. It is probably not novel to the committee, but we wish to make the comment.

The Acting Chairman: So that there would be no capital gains tax levied on anything you owned?

Mr. Sheperd: That is correct.

The Acting Chairman: But on anything you bought there would be capital gains tax?

Mr. Sheperd: That is correct.

Senator Isnor: You go beyond that, do you not? You buy in the first case and you could sell it and there is no capital gain, but it is only on something bought in the second case.

Mr. Sheperd: That is correct.

Senator Isnor: So it is different from your interpretation.

The Acting Chairman: So all the present assets and the first purchases are free.

Mr. Sheperd: No, the first purchase is the reference point.

The Acting Chairman: And anything purchased after valuation day is subject to tax.

Mr. Sheperd: Correct.

The Acting Chairman: You say that you are opposed to the deemed realization when an individual leaves the country.

If there were a capital gains tax, would this not permit certain individuals to avoid the payment of that tax, whereas individuals who stayed here and in time disposed of their assets, either by realization or deemed realization, would have to pay the tax?

Mr. Sheperd: We are being rather subjective on this one, Mr. Chairman, because of the mobility of our skilled work forces. This is referring to the middle income people and their transfer, as they are associated with multi-national companies. It would tend to take care of that problem, if there were more tax treaties with respect to the movement of our people internationally, as mentioned in item 9 of the brief.

This is one of the hazards of our industry.

The Acting Chairman: Item 6 of the brief is concerned with the tax on the first \$35,000 a year of a corporation's income.

Senator Carter: I wonder if they would tell us their definition of a small business?

Senator Benidickson: They do that by saying that the low tax should apply on profits up to \$35,000?

Senator Carter: How would you define a small business?

The Acting Chairman: I think that Senator Carter is referring to the problem that the low rate would thereby apply to all corporations, big and small.

This committee would like to find a definition of small businesses so that the low rate could do the job it is intended to do, rather than benefit people who do not need it.

Senator Kinley: Whether you are small or big business. That is what you are dealing with.

The Acting Chairman: That is right, sir. By virtue of the fact that they represent both small and big business, we feel that their observations on this point would be very worth-while.

Senator Kinley: Oh, yes, but the point is that if it is a small business, earning so much money, it is at a lower rate.

Is this organization an association of companies, or just an association such as a labour union?

The Acting Chairman: It is an association like a labour union.

Mr. McAlpine: It is very difficult to establish a criterion as to what is a small, young corporation. You might take the number of employees, area of plant or dollar value of sales.

An example of what I term a small corporation is a company I act for. It has a plant of 20,000 square feet, 25 or 30 employees, sales of about \$1 million a year, with earnings of between \$30,000 and \$50,000 a year. I would say that type of company is on the borderline between a small, growing corporation and a large corporation.

The Government has always used the test of the first \$35,000 profit. We see no harm basically in a large corporation getting the lower rate on the first \$35,000, because it is very difficult to draft otherwise.

One advantage of a small, young corporation is that they can produce surprisingly more efficiently and cheaply than the large corporation.

Mr. Sheperd may correct me should I be wrong, but many components are made on a separate contract basis by the small corporation, which keeps costs down and assists Canadian exports.

Possibly the differential between 21 per cent and the higher rate is too great. It might be graduated, but we feel that the first \$35,000 a year of earnings should

have a lower rate of tax. That is where the money is earned to put into new plant and equipment by the smaller corporation.

The Acting Chairman: And you think this should be available to a corporation no matter what its size?

Mr. McAlpine: Yes, I think in a large corporation the \$9,000 or \$10,000 does not matter very much.

Our main concern is to protect these small corporations. If it is not found suitable from a drafting standpoint to do this, fine, let them have it as well.

The Acting Chairman: We were hoping we could find some way of benefitting the small and not the large corporations in this regard.

Mr. McAlpine: We did suggest a quick depreciation of assets might be one alternative, rather than a reduction in rate.

The Acting Chairman: We have found on investigation that the problem in that regard is that many small corporations are not capital intensive, but labour intensive. A fast write-off may not really be of much assistance to them.

Mr. McAlpine: I realize that there were abuses in the past, with associated corporations and companies making efforts to have 40 or 50 corporations get the benefit of the low rate of tax on the first \$35,000 profit.

I personally have not found a great deal of abuse, particularly with the amendment under the Income Tax Act giving power to the Government to deal with associated corporations.

The Acting Chairman: There was a considerable amount of abuse before the addition of the discretionary section. I do not believe there has been too much abuse since then.

Mr. McAlpine: That is right.

Senator Carter: I am not sure that I heard everything the witness said. He mentioned as one yardstick the number of people employed.

How would you react to profits as a yardstick? How would you classify small, medium and large-sized businesses? Where would you go up the scale on profits to draw the line between these three categories?

The Acting Chairman: Mr. McAlpine is saying that he believes that the low rate should be available to all businesses, regardless of size, because it would be too difficult to create a test which would determine which is a small, medium or large-sized business.

Senator Carter: If the whole rationalization behind this 21 per cent was to enable the companies who were too small to go to the market for their capital, it certainly is geared to profits now in some way, is it not?

Mr. McAlpine: It is a problem to devise a satisfactory test other than one related to profits in deciding what is a large or small business.

It is very difficult to define it as area of plant or a certain amount of sales. Some companies use a great deal of labour, others a great deal of equipment.

So many tests would be required that legislation such as this would be too complicated to administer equitably.

Senator Isnor: There would be no variation if it were limited to a net profit criterion.

Mr. McAlpine: That is correct. We feel that the net profit test that the Government used in the past is about the best practical one.

The \$35,000 limit has worked fairly well over a period of years and we see no reason to suggest a different figure at this time.

Mr. Longstaffe: Our point is that we feel that the low rate on the first \$35,000 should be continued. However, if the Government does see fit to change this, certainly it should be done in increments based on the growing profit of the company.

There should not be any clean-cut breaking point where one day you are paying 21 per cent and the next day 50 per cent.

I would like to point out that Mr. McAlpine is technical adviser for our brief and is Chairman of the Financing Taxation Committee of the Ontario Chamber of Commerce.

The Acting Chairman: Thank you. We will move on to item No. 7, in which you suggest that the write-off on nothings is, I believe, a good thing.

Senator Hollett: Why are they called nothings?

The Acting Chairman: They are called nothings because they do not relate to tangible assets, such as good will, patents, franchises, and for that the White Paper chose to call them nothings.

Senator Hollett: It is nice to have them.

The Acting Chairman: They are sort of "something nothings".

Hon. Mr. Balcer: They are part of our natural resources.

Mr. Shepherd: We would like to talk about this for a moment. We note that other industries are given the opportunity to depreciate their natural resources, a depletion allowance, as it were. In our industry, we consider our natural resources to be patents, licences, and connections with other companies. We feel that definitely there should be some way in which the electronics industry can gain a depletion allowance for the years of its natural resources.

Senator Isnor: Such as.

Mr. Shepherd: Such as the patents, licences or whatever agreements we may have to have in order to allow us to have a unique position in our industry.

Senator Kinley: Do you get an extra depreciation on your electronic goods?

Mr. Shepherd: I have not compared our depreciation in terms of its classification and other cost allowances.

Mr. McAlpine: Honourable senators, item 7 agrees with the White Paper. I think the main thing the Electronic Industries Association members have is knowledge. Knowledge is not a patent so you cannot write it off as one. We were not basically concerned with good will, but the knowledge is constantly changing, because it is an industry subject to technological improvements, and that is what we want to write off—the cost of acquiring knowledge.

Canada is a small country competing in the world and our people have to work hard. They must be smart and have more knowledge than people in other countries. Anything that the Government does to encourage the development of knowledge in Canada is desirable from our standpoint.

The Acting Chairman: Does not the White Paper propose that?

Mr. McAlpine: Yes.

The Acting Chairman: Item No. 8, entertainment and related expenses.

Mr. Shepherd: I think the notes in the brief are self-explanatory on the need to be competitive. As an association we certainly are concerned about the fact that expenses in connection with the association, such as meetings, conventions, et cetera, would not be allowed as tax deductions under the White Paper. We certainly feel that trade associations provide an extremely important function, both for the industry and in matters of advice to the Government. We think that business would have to bear an unfair penalty if these were not tax deductible. This is well covered in our brief.

Senator Aseltine: What is the present law?

The Acting Chairman: The present law, senator Aseltine, is that items which are reasonable amounts laid out for the purpose of producing or gaining income are allowed.

Senator Aseltine: As a cost of doing business?

The Acting Chairman: Yes, and expenses that a taxpayer undertakes, or all expenditures he undertakes, are reviewed under this definition and those which are not reasonable and those which are not laid out for the gaining or producing of income are not allowed as expenses and are charged back to the taxpayer. That is one thing I was interested in. You say in the penultimate sentence in paragraph 8:

To the extent that club and convention expenses are entertainment expenses related to the promotion of a business and thus to earning income, they should be allowable. Abuse and excessive use can and should be curtailed.

I would have thought under the present law that there is already severe curtailment by virtue of the operation of that section. To my knowledge it has been only operating for a number of years. You seem to indicate that it has not been operating to your satisfaction.

Mr. Shepherd: The provisions in the brief that already exist take care of abuses.

Senator Aseltine: If the provisions of the White Paper become law I would not be able to deduct the cost of going to the Canadian Bar Association.

Senator Isnor: They would say you have enough knowledge.

Senator Aseltine: So I am all in favour of this.

The Acting Chairman: That is after the association's recommendations.

Mr. Shepherd: We cannot help but feel that the proposals in the White Paper would lead to more skulduggery than abuses that currently occur.

Senator Aseltine: Such as hockey tickets and excessive entertainment.

Mr. Shepherd: These can be curtailed now under the law. I think people would spend a great deal of time trying to call what they are doing something else than what it really is.

The Acting Chairman: Item No. 9, international income. Are there any comments?

Senator Aseltine: We have had a lot of representation on that same point.

The Acting Chairman: We would still like to hear your comments. There may not be too many questions on it, however.

Mr. Shepherd: The only thing we would like to elaborate on is that we feel that more foreign income could be generated for this country if we were allowed a 10 per cent investment dividend income rather than a 25 per cent investment dividend income. This would allow us with a 10 per cent investment income to have an affiliation with overseas operations which would be potential customers. It would also allow the flow of dividends back to the country for further reinvestment, research and development. I think that is the extent of our statement on that.

The Acting Chairman: Thank you, Mr. Shepherd. Are there any questions on that, honourable senators?

Senator Carter: I have no questions on that, but I do have one general question before we wind up.

The Acting Chairman: Do you have any further statements on your brief?

Mr. Shepherd: No.

Senator Carter: Mr. Balcer mentioned earlier the difference in prices in Canadian manufactured appliances and the United States prices. How does the productivity of the electronics industry compare with the productivity in the United States?

Hon. Mr. Balcer: We think we are doing very well. Let us not forget that we are faced with the competition of a huge American market and also the low labour of Japan, but I think that, as far as productivity is concerned, we do not take any back seat.

Senator Carter: Would you say that we are on par?

Hon. Mr. Balcer: Yes. To give you an example, for instance, when the Olympics were held in Mexico City it was a Canadian company which was successful in the tenders for the microwave system to bring this television broadcast from Mexico city to the American networks. Our Canadian company won against all the American companies which were competing with them. We also compete very successfully in Pakistan, Iran, Turkey, Greece and various places like that. As far as the know-how is concerned, I do not think we should take any back seat. In regard to telesat, in the satellite field, for instance, we have had the first domestic satellite in operation and it has been very successful. The Alouette and the Isis were both very successful. I can name all kinds of activities of that kind, in the consumer field, where, as I said earlier—and I am sorry to be out of order again, Mr. Chairman—I think this 15 per cent in excise tax is the main reason for the difference in cost of Canadian television appliances as compared with United States appliances.

Senator Carter: What about the scale of production? Is that a significant factor?

Hon. Mr. Balcer: Of course, they have this great advantage of the huge United States market, but we have, for instance, Electrohome who are exporting to the United States and doing so very successfully, with goods made in Canada. In many other areas, other producers in Canada are exporting to the United States and other countries, but mostly to the United States.

Senator Carter: Thank you.

Senator Isnor: The closer you are to your market and the bigger that market, the better chance you have to compete, is that not so? That has something to do

with the cost of your production and the cost of selling?

Hon. Mr. Balcer: As far as transportation is concerned, it is a very minor item in electronic goods. This transportation cost is a very small item. It is not a big factor. The fact that we have this huge market, it is a great thing for Canada, but on the other hand we have to face very stiff competition from the United States producers who have also this huge market.

Senator Isnor: We in the Maritimes always felt that we were at a disadvantage in sending to central Canada, to the city of Toronto, as compared to the Ontario manufacturer.

Hon. Mr. Balcer: It is quite true, in many manufactured goods, but this is one advantage we have in the electronics field, that transportation is not a major item. One can carry in a plane load a lot of electronic components, for instance. However, it is still a factor.

Senator Carter: What we do is bring in component parts from the United States and assemble them. We do not export them? You export component parts to the United States?

Hon. Mr. Balcer: Yes. Mr. Longstaffe here is the executive vice-president of the Renfrew Electric Company, a manufacturer of components, and I am sure he can answer that question.

Mr. Longstaffe: I am a component manufacturer and also chairman of the components division within the association. We are exporting at the present time some \$50 million worth of components, to various countries in the world. In addition to that, we are supplying at least a portion of our own domestic market. I recognize that there are components brought in from the United States and from Japan and other countries, that are assembled in Canada, but our efforts are directed the other way, to change that tide.

Senator Carter: Could you say what percentage of the domestic market you have in components? Would it be 10 per cent?

Mr. Longstaffe: It is 33 per cent.

Senator Carter: Thank you.

Senator Hollett: Did you say \$60 million worth of components?

Mr. Longstaffe: It was \$50 million worth.

Senator Kinley: And Marconi?

Mr. Longstaffe: Yes, Marconi are mostly in the industrial fields.

The Acting Chairman: They are under Canadian Marconi, senator.

Are there any further questions? If not, honourable senators, I would like to thank these gentlemen very much on your behalf. Thank you for your presentation this afternoon.

The Acting Chairman: Honourable senators, the next presentation is that of the Canadian Welfare Council, whose representatives are here this afternoon. I would ask Mr. Racine, the chairman of the council's executive committee, to introduce to you the members of his party and then to proceed with his opening statement.

Mr. H. S. Racine, Chairman, Executive Committee, Canadian Welfare Council: Mr. Chairman and honourable senators, the members here are Mr. Bruce Philip, who is the Chairman of the Canadian Welfare Council Taxation Committee. He is a member of the firm of Riddell, Stead & Co., Chartered Accountants, Ottawa. Mr. Philip is also Treasurer of the Consumers Association of Canada. Dr. R. E. G. Davis is a member of the Canadian Welfare Council Taxation Committee, formerly Professor of Social Policy, School of Social Work, University of Toronto. I am sure Dr. Davis is well known to all of you for his work with the Senate Committee on Aging and as a former Canadian Welfare Council Executive Director. To my right is Mr. Reuben C. Baetz, the present Canadian Welfare Council Executive Director. Also to my right are Miss Patricia Godfrey, Executive Secretary, Canadian Welfare Council Special Projects, and Secretary to our Taxation Committee and Mr. Michael Wheeler, Canadian Welfare Council Director of Research, and Consultant to the Canadian Welfare Council Taxation Committee.

[Translation]

Mr. Chairman and honourable senators, as Chairman of the Executive committee of the Canadian Welfare Council I would like to thank you for the opportunity of presenting our brief. It is not the first time that the Canadian Welfare Council has appeared before a Senate committee, and there is no doubt that we will

have the opportunity for discussion in a constructive and possibly controversial manner as we have done in the past.

[English]

The Canadian Welfare Council, because of its wide membership, both organizational and individual representing a broad cross-section of Canadian society interested in social welfare, is in a position to speak out on major issues affecting the social development of Canada, and we believe that taxation is one such issue. We are also in a position to call on the advice of experts to assist the Council in the technical aspects of our policy statements. We are thus fortunate in having taxation experts and economists, as well as experts in social welfare, in the membership of the special committee that prepared our submission to you.

The committee worked within the framework of established Council policies, and the conclusions in our statement do not necessarily reflect the views of each individual committee member, in all instances, but the document represents a consensus on ways in which we believe the tax system can be utilized to achieve the Council's objectives.

Now, with your permission, Mr. Chairman, I would like to call on Mr. Baetz to introduce our submission to you.

Mr. R. C. Baetz, Executive director, Canadian Welfare Council: Mr. Chairman and honourable senators, we are particularly pleased to appear before you today, because our presentation is going to be mainly on behalf of a group from whom little or nothing has been heard so far in the heated discussion on the White Paper proposals. I am referring, of course, to the low-income group, the poor, the most vulnerable members of our society. This category of Canadians has been the special concern of our Council throughout our 50-year history, as we have tried to work on behalf of the welfare of all Canadians.

As I am sure honourable senators know, the low-income people are fortunately beginning to develop a strong voice of their own on many matters. Taxation is such a mysterious and formidable subject for most people that it is hardly surprising that the poor have not been coming here to present their briefs on this particular subject. The poor simply are not organized to obtain the services of the taxation experts and the economists, as have some of our well-to-do citizens and, of course, as the corporations are doing here daily before you.

The Council has been fortunate, however, in getting invaluable help, on a voluntary basis, from taxation

experts and economists who do have a deep personal interest in how the taxation system can assist the less privileged groups in Canada. I think we would do well to remind ourselves that when we speak of low-income Canadians we are speaking of a substantial percentage of our population. Almost 20 per cent of Canadian families and an even more shocking 40 per cent of individuals living on their own fall into the category of the poor. The very fact that such a substantial percentage of our population lives below the generally accepted poverty line should heavily influence our thinking as we set about the reform of our taxation system. Moreover, we should keep in mind that the poor are by no means all a so-called "burden on the public purse." Many are the working poor, carrying full responsibility for themselves and their families. Let us also keep in mind that as a total group the poor contribute substantially to the public revenues. In 1967, for example, 54 per cent of our federal income taxpayers had an income of under \$5,000 and paid almost 20 per cent of the personal income tax collected by the federal Government. These revenue figures do not include the contribution by the poor to our taxation revenues through taxes such as the sales tax and property taxes.

The Acting Chairman: How do you define "poor" there?

Mr. Baetz: I refer to \$5,000 and under in this particular category of low-income families.

Senator Carter: What percentage was that?

Mr. Baetz: In 1967 54 per cent of our federal income taxpayers had incomes of under \$5,000, and together this group paid 20 per cent of the personal income tax collected by the federal Government. Of course, in addition to that you have to add their contributions to sales taxes and to property taxes passed on to them through rentals.

The Acting Chairman: In defining poverty levels, the Economic Council of Canada and the O.E.O. in the United States grade those levels on the number of dependents. I gather your norm is \$5,000, whether a person is single or whether he has six children.

Mr. Baetz: No, this is not particularly a norm. I am simply trying to substantiate the case here that people in the low-income category—and we are assuming that a family with less than \$5,000 is a low-income family—do in fact pay substantially to the federal treasury.

The Acting Chairman: You may well be right and you probably are, but one of the problems with that is that that is not family income, but that is individual income, so that a family may have a number of income producers. Also it includes all the people who have taxable income who are single and who may be dependents of somebody or who may be living in a household where there is another wage earner. I would be interested to know what the figures are for the poverty level set by the Economic Council. Would you have such figures?

Mr. Baetz: I think we do.

Senator Cook: Is that \$5,000, taxable income or gross income?

Mr. Baetz: Gross income.

Miss P. Godfrey, Executive Secretary, Special Projects, Canadian Welfare Council: Actually, these revised "poverty lines" of the Economic Council in 1968 were \$1,800 a year per single person, \$3,000 for a family of two, \$3,600 for a family of three, \$4,200 for a family of four, and \$4,800 for a family of five. Allowing for 5 per cent reduction in purchasing power due to inflation in 1969, the new levels are raised accordingly up to \$5,040 for a family of five. This is footnote No. 23 on page 22 of our submission, if any honourable senator wishes to look at it.

The Acting Chairman: What is the poverty level for the 5 per cent, compounded what? How many years?

Mr. Baetz: The statistics were in 1968, so it is compounded for one year.

The Acting Chairman: So it is \$1,890 for a single person?

Miss Godfrey: Yes.

The Acting Chairman: Below that, according to the definition, this puts him in the poverty line, but such a person making \$5,000 of gross income might well be considered above it.

Mr. Baetz: I think we should clarify one point here. That is, we are not trying to say that any family at a \$5,000 level of income or under is living in poverty; we have not tried to make this case. We are simply citing as an example the percentage of taxpayers, not necessarily poverty stricken, but those with low incomes who do contribute to the federal Treasury

who fall into this category. I did not try to relate \$5,000 . . .

The Acting Chairman: No, I was not suggesting that you were being misleading at all. It is just that we would be very interested if you could produce for us at any time the amount of contribution in the form of taxes to the federal authority that people living below the poverty line by the adjusted definition of the Economic Council of Canada pay in percentage of the total tax take.

Miss Godfrey: That is not available from the DBS at the present time.

Senator Carter: Also information on earnings, because if a man and wife had no children and they were both earning \$5,000, they would have a total income of \$10,000, which would not be a bad standard of living. However, they would still be included in this total according to the manner in which the DBS compiles it figures.

The Acting Chairman: That is what Miss Godfrey says, that the figures are not available on that basis at this time.

Mr. Baetz: Our Council's general approach to taxation is that the taxation system can be a powerful instrument in producing the Just Society. In other words, taxation can have a social purpose as well as an economic goal. We are therefore delighted to note that the White Paper does accept a social purpose for taxation. We salute and endorse the introduction of this as official policy for the first time, we believe, in our taxation system. We are, of course, as you know, critical on a number of points of the degree to which the proposals of tax reform live up to this goal.

One of our major problems in responding to the White Paper on Taxation is that the federal Government has not yet issued its White Paper on social security. We believe there are two ways to help the poor through the tax system. The first is, of course, through direct easing of their tax burden; without this we could simply take from the poor with one hand and give with the other. The extent to which the poor can be helped through easing their taxation burden has limited effectiveness because many of them are below the tax level in any case.

The second way to help the low-income Canadians through the taxation system is, obviously, to raise sufficient revenue to pay for social programs necessary to help them.

As we have said in our brief, raising revenue through taxation and public expenditure are simply two sides of the same coin of the Just Society. You may have a very progressive and equitable rate structure, but this may be negated by the way the money is spent.

It should be emphasized that we are not only thinking here in terms of adequate social service expenditures. If an undue amount of our total public expenditures goes to those programs and projects which cannot to any extent be utilized by the poor, we create an element of inequity.

Possible examples are numerous. Public expenditure, for example, to maintain a canal system used for luxury yachts may be a good example as we begin our summer tourist season. Expensive opera houses and arts centres which the poor cannot afford to attend are another. Universities to which the poor probably will not be able to send their children provide an additional example.

The inter-relationship of taxation and public expenditures on our social security programs has been recognized in the White Paper in that it defers consideration of income tax deductions for children until the proposed changes in Canada's social security and social development programs are known.

But how do we know, for example, how valid the concrete proposals that have been made in the White Paper on the personal exemptions would be, in the event that some form of negative income tax should be proposed shortly as part of our social security system? We cannot criticize the tax experts on this; it is not their job to devise social policies. But the council believes that the public should have an opportunity to consider the Government's social policy and tax proposals together. It is therefore imperative that the White Paper on social security be released now.

We fully recognize that the social objectives of a country may not always be economically possible. As we state in our brief, "a sound economy, based on a satisfactory level of productivity, is a prerequisite to the social development of any country".

We take issue with those who would say that economic progress is our ultimate objective. Economic progress is but a means to an end, which surely is a greater degree of social justice, equality of opportunity, and an adequate standard of living for all Canadians. This does not mean equal income for all. Nor does it necessarily mean a decrease in the present level of income for the middle and upper income groups—

although it may slow down the rate of increase in their incomes.

I have not attempted to touch on the submission's comments and suggestions on specific proposals of the White Paper. Mr. Philip and the rest of us here are at your disposal to discuss them in detail as you may wish. I have simply tried to highlight the framework within which the Council's statement has been developed.

To some of you this may seem a far cry from the nitty-gritty of rate structure and tax policy. But at the beginning of its second century, and in a troubled society both within and without our country, Canada faces important choices "among differing judgments as to her social and economic priorities and goals". We have sincerely tried to contribute constructively to this public dialogue.

Thank you, Mr. Chairman.

The Acting Chairman: Thank you, Mr. Baetz. Are you opposed to the concept of growth of the economy?

Mr. Baetz: Not at all.

The Acting Chairman: Is there anything in your brief from which one might take that impression?

Mr. R. E. G. Davis, Taxation Committee, Canadian Welfare Council: Growth for what? What is the purpose of growth? Growth in itself is not an end, is it? Why economic growth?

The Acting Chairman: I am asking you to answer the question that I put.

Mr. Davis: Which is?

The Acting Chairman: Is there anything in the statement of the council that indicates that you are opposed to economic growth?

Mr. Davis: I would not think so.

Mr. B. Philip, Chairman, Taxation Committee, Canadian Welfare Council: On the contrary, the statement says quite clearly that the council recognizes the need for a dynamic economy to support necessary social programs. There is certainly no suggestion that the economy nor the activities in Canada should be dampened down. The question as to how the resources are used then concerns the council.

The Acting Chairman: Your feeling is then that there has to be a balance between those policies that will promote growth and those that will promote a fair distribution?

Mr. Philip: The council's position is that they go hand in hand in creating a better country.

Mr. Davis: Growth would be for the purposes of promoting a better social life for the people. That is the purpose of economic growth, is it not?

The Acting Chairman: Perhaps you and I should change places and you ask the questions. There has been an opinion to the effect that concentrating on growth in the economy is wrong per se, that what we should be concentrating on is the quality of life. In fact, growth is inimical to that concept of the quality of life. I was wondering what the council's opinion of this was. You have stated that you feel you are more concerned with growth than distribution. They are equal partners.

Mr. Davis: I was not thinking of the contest between growth and distribution. It is the use of a kind of inside mobility. Distribution may be part of it, but it involves more than that. It involves the question of the social goals to which our economic growth is directed, one of which may be distribution, but you could still improve the quality of life independent of distribution.

The Acting Chairman: I was using the term "distribution" in its broadest sense.

Mr. Philip: It seems to me that this is quite clearly stated on page 18, item 25:

Public policies that can produce a dynamic economy capable of supporting full employment, sound manpower practices and adequate wage levels are prerequisites to the council's recommendations on social security.

The Acting Chairman: I think that is quite clear.

Mr. Philip: That is pretty clear as far as the council's policy is concerned.

Senator Molson: I believe the Canadian Welfare Council came out in favour of the Carter Report, did it not?

Mr. Philip: Not in every respect, no. We endorsed certain principles, which have been repeated in our brief, some in the form of recommendations.

Senator Molson: I saw the matter raised somewhere in the press, and that is what reminded me of it. I was wondering if there had been any fundamental change in your thinking since that time or if the same points are valid today?

Mr. Philip: I do not think we made any conscious effort to try and remain consistent. The committee charged with the responsibility took a completely new look, because of new personalities on the committee, at the White Paper proposals and how they fitted into the overall policy of the council.

Senator Carter: You did not go back to any reference to the Carter Commission?

Mr. Philip: We certainly took recognition of some of the positions taken by the council of that day. One of the impressions you might have gotten is that the council embraced the Carter Commission Report; the Carter Report embraced one of the council's recommendations as to the family unit. As a result, where the Carter Report was substantially built on the family unit premise, that came out of the council's original submission to the Carter Report. There was an alignment there of thinking, originated publicly by the council's submission.

Senator Molson: Thank you.

Mr. Baetz: I do not know which came first, the Carter Report or the council's recommendation regarding the taxing of some of the social benefits and social security payments. This has been repeated in this particular brief and it is something that is perhaps not always understood and perhaps in some instances misunderstood by people who say, "Why do you insist on paying income tax on social security benefits?"

Mr. Davis: It is true that Mr. Carter was at one time President of the Canadian Welfare Council. He wrote a letter shortly before his death stressing the council's influence on his thinking. To that extent there is some linkage with Mr. Carter.

The council made a submission to the Carter Commission, but I do not know that the council made any official statements subsequently endorsing the Carter Report.

Miss Godfrey: It did not actually make official statements, but welcomed certain aspects of the report that had been in our original submissions. I think I should add that our original submissions were on the invitation of the commission in its very early days to

present subjects which we thought ought to be explored. For example, in our reference to the family unit what we said was, and I think it is quoted here, that the tax system ought to take more account of the family as a unit. We have never gone further into exploring how this should be done. We have suggested here that there ought to be consideration of this, because it is a fundamental point if you go into it at all.

If the council had looked at this in detail it might have modified its ideas at that time: It never went into how far the idea should go or what family members should be included. Our original submission was more in the order of suggesting areas for exploration than specific strong recommendations. We certainly raised the question of taxation of social benefits and we formally came out with this in our "Social Policies for Canada" a year ago.

The Acting Chairman: Perhaps we can now move forward with the specific considerations.

Senator Carter: I would like to get the reaction of the witnesses to the proposal which we had from the electronics industry this afternoon about the private sector taking over some responsibility for welfare.

Mr. Baetz: I shall make a very introductory comment. I think private industry for many years has had an opportunity to assume more responsibility. I do not think it did a particularly good job of it. There are certain areas today where private industry might take the initiative in providing some social services. I am thinking of day care services for working mothers. This would be a possible area.

Senator Carter: I think you said they have not been drawing unemployment insurance in some cases.

Mr. Baetz: I do not see much possibility or likelihood for the private sector to be able to assume universal responsibility for people in need to provide the social welfare services that the gentleman from the electronics industry suggested. At the very best they might provide some assistance to those people who are employed, but surely that is not where the heart of our social assistance is required. It is the people who are not connected with the labour forces who are often in the greatest need, such as the handicapped, aged and young. I would be glad to hear what some of my colleagues have to say.

Mr. M. Wheeler, Director of Research, Canadian Welfare Council: We already have examples in which

industry has introduced various social services programs in health care, and there is the guaranteed wage in the auto industry to some extent. These are all examples of ways in which it has been possible for industry to take action.

Over the years the responsibility has been transferred to government, because this is where the greater resources are. I am often concerned about comparisons with other countries and societies, based on the assumption that what they do is equally applicable to Canada. In Japan to which the electronics people referred, there is a very different kind of society, a traditionalist one, and one which has demonstrated in the past certain of the disadvantages of such a society, an authoritarian one. I am not sure whether we would wish to import that kind of society and the labour immobility which comes with these kinds of programs.

The Acting Chairman: It is a tremendously paternalistic society.

Mr. Wheeler: To the employers of Canada or the workers of Canada, the idea of people remaining with one firm all their lives would be unusual.

Senator Benidickson: That is what appealed to me, that it was not typical of anything we have here and there would be a great outcry if something that curtailed mobility and in addition give them all the terrible gaps that exist from the point of view of the desirability of universality in the application of programs. We can have a basic plan, something on the public sector that is basic and universal. There is nothing to prevent new industries from supplementing that an improving upon it, but I think you must have a basis in these days, that is public.

The Acting Chairman: Perhaps we can move on to the specific recommendations.

Senator Carter: You recommend tax credit instead of tax exemption. Do you have in mind a flat rate, a sliding scale? Would you give a person the same tax credit for a child six months old as you would for a 15-year old?

Mr. Philip: I think the main thrust of our recommendations is what we believe to be equitable treatment of the allowance as it may be decided as between a tax credit and an exemption or deduction system. I do not think that really deep consideration was given to the dollar amounts which should be given, or whether as a matter of public policy the Government wished to give additional support to either younger

children or to older children. It seems to us that this was somewhat of a separate issue.

Our main consideration is that at the present time a standard deduction of the same amount is given for all children regardless of whether their age is one or sixteen and that such benefits would be better used or more equitably used if they were moved from a deduction to a tax credit form. The council's view is that a still better step would be a direct payment scheme such as family allowances, that this method would be more equitable overall.

The Acting Chairman: Rather than an exemption?

Mr. Philip: Rather than an exemption. If we were taking our preference, we would have direct payments in increased family allowances, followed by the second preference, tax credits. I suppose that a further step here would be tax credits which were actually refunded which really brings you the same as payment of family allowances. Tax credits alone—with no refunds—would be preferable to the deduction which would be our last choice.

The Acting Chairman: One of the things that worries us about the deduction is the point that you make in item 30, that it offers a greater relief to those in higher tax brackets.

Mr. Philip: That is right.

The Acting Chairman: You go on to say that:

The council recognizes that equity can be achieved in a system of flat exemptions given to everyone, such as the basic personal exemption, by taking into account, in formulating the rate structure, any changes in the exemption levels.

Do you think that is done under the proposed new rate?

Mr. Philip: I would say that in our discussions, and I am sure in a lot of discussions, the setting of the rate schedules is a mystery. I am not sure whether they are set scientifically or set by lining up a wide variety of rate schedules and arriving at what you want the total revenue to be. I would think it is probably the latter rather than the former.

The Acting Chairman: That is something we will never know.

Mr. Philip: I am sure we will not know. We would have to assume, I suppose, that in the examination and

determination of the rate schedule, if there was going to be an equitable rate schedule established, that that factor would be taken into account. I do not think that you will ever know whether it is or is not.

The Acting Chairman: But you would rather see it paid by an addition to the family allowances.

Mr. Philip: We are talking here about two different things. The basic exemption can be adjusted, the \$1,000, as it is now, can be adjusted, if it is moved to \$1,400, by an adjustment in the rate schedule. So, it takes everybody out of the bottom rather than taking the extra 400 off the top. That can be done equitably by the science of setting a rate schedule. That cannot be done for children's allowances or children's deductions unless you have a separate rate schedule for single people, for a married person with one dependent, married with two dependents, married with three dependents, and so on. Then you can do it, with about 15 rate schedules. Without that, the only way you can get equity in changing the exemptions or changing the children's exemptions is to have a tax credit.

The Acting Chairman: We shall pass on to the next item, the family as a tax unit. You regret that consideration of this was postponed. Do you have any comment on that?

Mr. Philip: I said earlier, I think the council's initial presentation to the Carter commission was that the matter should be examined. Carter did give it substantial examination and came out in favour of it. I do not think this presentation particularly suggests that we support Carter's position or do not support Carter's position in that regard. But in the light of the current situation, surely when the Carter Report was so substantially based on this premise the matter should have got fairly extensive consideration in the White Paper presentation, it should have been either accepted or rejected and the reasons given.

The Acting Chairman: Honourable senators, are there any questions on that? If it were considered as a family unit, that would be more in conformity with the whole concept of poverty allowances.

Mr. Philip: The council felt that we should be striving for a closer recognition of the family in total and that this is a very proper recognition in the income field when we are looking at the poverty level, just as you suggested in an earlier discussion that in the lower income group all the revenue that flows into the household is important in looking into whether

that household needs assistance or not. Surely, if that is the case, when we are looking at taxing people, we have to look at all of the revenue that flows into that actual unit. So we think there is merit in examining the idea. I think that our disappointment is that you have a tax reform that postpones consideration of a major item in what we are supposed to be talking about, a major reform.

The Acting Chairman: That is, the negative income tax?

Mr. Philip: No, that is the family unit. It is dismissed; consideration of it is postponed.

The Acting Chairman: That would give rise to the family unit. You could presumably deal much more readily with the concept of a negative income tax.

Mr. Philip: I would think that if you want to offer social programs or social assistance to a family unit, certainly that would be a federal measure. Your program could run into criticism because of obvious inequities that you could illustrate in a non-family unit situation where you cite two unmarried people, living as a family, and one was on a negative income tax, the woman was on a negative income tax because she was unmarried and the man was on \$10,000. I suppose there could be some major arguments against the negative income tax system considered in the context of the family unit.

The Acting Chairman: In a simpler form, that was the problem of the \$5,000 he mentioned in his opening statement. If it was a family \$5,000, or related to the family unit, it would be understandable more readily and you could then take action to cure the defect.

Mr. Philip: I think that in our opening statement we wanted to put forward something to dispel the impression that the only people who contribute to the national purse are the major corporations and the major taxpayers. People with modest incomes do contribute substantial portions of personal income tax, and they also contribute through sales taxes and property taxes. We did not attempt to get into the measure of poverty at that point.

Senator Carter: I am not quite clear as to how this system would work if geared to family units. Are you talking about different rates for different sized families—that is, a family of seven would pay a different rate of income tax on the taxable income?

Mr. Philip: We do not try to deal with that aspect from an analytical point of view, but the Carter Commission report suggested that all the income coming into a family would be taxed on a scale, and that scale would allow for certain differences in family size, but you would lump all the income together rather than having it separated as individual situations now. There were some basic principles set out in the Carter report as to who should pay higher income taxes, what type of combinations, and how you develop a rate structure.

Senator Carter: But all the income coming into a family might not contribute to family income.

Mr. Philip: That is one of the criticisms that was brought up, certainly by the ladies in the country who felt that they should keep their own dollars, one of the criticisms of going to the family unit. It is something that needs substantial consideration before any legislative action is taken on it.

Senator Carter: Somebody spoke about the close link between the Welfare Council and Carter. I do not know whether you got that idea from him or whether he got it from you, but has anybody thought it through?

Mr. Philip: There are some substantial position papers put forward in the Carter considerations, and the Carter report contains a substantial amount of material on it. I doubt if there is any more authoritative basic research on the subject at the present time, but that would certainly produce a base for further consideration of the question.

Senator Carter: Did you get as far as defining what would be called "family income"?

Mr. Philip: Oh yes.

The Acting Chairman: Mr. Carter did that.

Senator Carter: How did he define it?

Mr. Philip: He defined income in a very broad sense of the word. He defined it as including not only the normal portion of income but also capital gains, gifts received, gifts received on succession, and any appreciation in a person's wealth. In other words, it was finally determined that a buck is a buck. So, to that extent, the research done by Carter probably would not help your committee in looking at what would be included in family unit income, but certainly the

structure of the family unit could be considered by looking at that research, and then the proposals put forward in the White Paper could be brought in and, instead of being taxed on an individual basis, people would be taxed on the family unit.

The Acting Chairman: I think what they are saying, Senator Carter, is that the objectives of the Canadian Welfare Council could probably be more readily fulfilled, as they relate to taxation, if the family unit concept had been used rather than the individual concept used under the White Paper? Is that right?

Mr. Philip: Yes.

The Acting Chairman: Perhaps we could move on. We have dealt with deductions for dependents. Is there anything you would like to say on child care expenses?

Mr. Wheeler: As we pointed out in the brief, we accept the proposals as an interim measure, recognizing that they will bring some assistance but they suffer from the same kind of disadvantages that have been pointed out in connection with tax deductions for dependents, in as much as they give greater benefit to those with higher incomes and offer nothing at all to those whose incomes are not taxable.

There is some evidence from a study by the Department of Labour that approximately 70 per cent of working mothers—according to the survey made in 1967 which has not yet been published—make arrangements for the care of their children involving no payment, and that a large proportion of these mothers have very small income. So that while we would be reluctant to look this gift horse in the mouth, we certainly think it should be considered as an interim measure and be followed by measures that help to increase the supply of day-care services and put them where the need is.

Senator Benidickson: That is using a tax system that does not help the ones that need it most.

Mr. Philip: It is an appropriate tax measure to recognize there is a business expense involved in getting extra employment, but the Council does not want to appear to say that solves other aspects of the problem which are substantial.

Mr. Davis: Mr. Chairman, I wonder if this does not raise the general question that bothered us as we prepared the brief. We welcomed with some en-

thusiasm the evident effort of people who prepared the tax proposals to distribute the burden of taxation in a fair way, according to ability to pay. We would endorse that principle enthusiastically, but I think we have the uneasy feeling that when it came to applying this, very crude methods seem to have been used. Perhaps that is the best they could do at this stage. Take a single example, the exemptions. The personal exemption for an individual used to be \$1,000 so it is raised to \$1,400. What is the rationale for \$1,400? If it is inflation since 1949, it should now be \$1,600, just to keep pace with inflation. If you follow the Economic council, it should be \$1,800, if that is the figure we are going to accept for a single individual. But, no, they White Paper comes out with \$1,400. It sounds more like an aesthetic judgment than a judgment based on any study of need or circumstances. That goes through the report at various points. The exemption benefits, as has been pointed out, will do more for the wealthy than the poor.

Senator Aseltine: Do you expect them to change it and raise it?

Mr. Davis: I am only saying it is difficult. Another point in this connection is that while we are endeavouring to relieve the burden or distribute it more equitably and help the lower income groups, we deal with only one segment of taxation—namely, the income tax, which produces some \$7.8 billion; but there is another \$7 billion or \$8 billion that is collected through the sales tax, property tax, and now through the capital gains tax, not to speak of social security contributions. You have to put all these together before you can say what kind of incidence the total burden of taxation has. Just to take this one thing, the income tax, and deal with it as though the others did not exist, means you are dealing with a puzzle with only some of pieces in the puzzle. Therefore, it is impossible to say what is the social impact of these proposals on the lower income group. I do not know what we can do about it, and perhaps nobody else does, but we are working in the dark on the social side, the social consequences of these proposals.

The Acting Chairman: I know. In our Standing Senate committee on National finance we have tried on several occasions to obtain statistics to show the total impact of taxation. You get so far down the road and it breaks down. There does not seem to be anyone either here or in the United States who has been able to do anything other than approximate the incidence of taxation as a totality.

I agree with you that if we are really going to succeed in reforming taxation we must cover the whole field.

Senator Cook: You have to start somewhere. If you consider the whole field you do nothing at all.

Mr. Philip: It is extremely important, in order to make a judgment as to the impact on the middle-income group also, to consider all these other areas.

These proposals appear to place a fairly heavy burden on those earning between \$20,000 and \$25,000. Probably that is the area upon which the sales tax falls most heavily. They spend a greater percentage of their income than any other group on sales tax items. The groups below that level spend a great proportion of their income on non-taxable items, food, children's clothes and, to some extent, housing. The groups above that probably spend a proportion of their income in investment situations which do not carry sales tax. Therefore we have a concentrated burden of all the taxes in that middle-income group.

Senator Cook: In section 22 on page 16 you say that the top marginal rate should be appreciably higher than the 50 per cent and should be reached beyond the level of \$24,000 now proposed. It would be very helpful to us if you could be a little more precise. What do you suggest should be the top marginal rate?

Mr. Philip: We are not really too clear as to how the rate structure was set so any view would be just a judgment on an individual basis. Our committee in discussing the matter certainly would not have advocated anything above 65 per cent and probably somewhere between 60 and 65 per cent.

Our concern was not necessarily with increasing the 50 per cent rate to 65 per cent, but to have a gentler progressivity below and past the \$25,000 level. To the extent that policy dictated that additional funds had to be raised to offset the revenue lost by that change, the rate could go above 50 per cent.

We would be prepared to see part of that loss offset by a rate over the 50 per cent level. I do not think any one of us would wish to see it. Certainly this could be an area where the Government should consider using part of its \$600 million of extra revenue to soften that progressivity.

Senator Cook: I agree that there is nothing sacred about 50 per cent. I am trying to find out what you think should be the maximum.

Mr. Philip: One of our concerns is that a person earning \$20,000 now, with 10 per cent of his income in capital gains, is not going to take great solace from the situation of a man who has \$100,000 now with 10 per cent additional in capital gains and is going to pay a smaller increase proportionately than the \$20,000 tax-payer will.

He is going to be hit with increased taxes plus more on his capital gains and see a reduction given to a person who is substantially better off than he now is.

We do not feel that, although capital gains may in total be higher in the upper income levels by percentage of income, they are that much greater when you consider that we are discussing the group between \$15,000 and \$25,000.

The Acting Chairman: Perhaps we could move on to the employment expenses. You heard the Electronic Industries Association and their view on expense account living.

I would gather that your view is slightly different.

Mr. Philip: I do not think we would suggest that abuses cannot possibly be brought under control now by the present legislation. I do not think we would support the view that they should all be eliminated. We are trying to be practical and say that proper expenses to earn income which is taxable should be deductible, so that our view does not differ materially from the business associations that have put their views forward. We would certainly not like abuses to continue, and if there are any legislative requirements in order to bring them under control we would support them being established.

The Acting Chairman: That is most interesting. As you know, the White Paper proposes to do away with certain expenses, and that is all there is to it. The submission made by people like the Electronic Industries Association, with which I gather you do agree, is that the reasonableness of the expenses in the discretion of the Minister of National Revenue is the test, and the better test.

Mr. Philip: I would think there would be some disagreement if we got down to the nitty gritty of what is reasonable.

Senator Benidickson: Yes.

Mr. Philip: But in principle I do not think we disagree.

Senator Benidickson: Most finance ministers would perhaps be interpreting "reasonable" along the lines you have in mind.

Mr. Philip: Well, we would hope they would.

Senator Benidickson: I think so, when they are short of money.

Senator Cook: It would seem that the tax collector is getting a good deal more sophisticated over the years on the ground of what is reasonable and what is not reasonable.

Mr. Philip: Yes, I would think that is probably true. I still think there are some wide gaps that are open to question.

Senator Benidickson: With respect to the other type of deductions which are introduced for the first time the flat deduction or expense to earn a living, the \$150 item, and also in reference to the possibility of a flat rate with respect to charitable donations, you attack both those and say in the first instance this business allowance of \$150 should, if it is a flat rate, be \$50, and then there should be vouchers to establish that the claim is for something that is not universal among taxpayers.

Mr. Philip: We consider that every taxpayer probably incurs similar costs to do his job. If I work in a garage I wear overalls, and if you work in the Senate you wear a suit. There is a great similarity between the kind of expenses, and we think the deductibility should be limited to where special expenses are necessary. That is certainly an area now that is wrong.

Senator Benidickson: On charitable donations, which has been in effect for some time, many people claim the \$100 and may not give anybody anything.

Mr. Philip: That is correct.

Senator Isnor: They show receipts.

Senator Benidickson: No, you get your \$100 without receipts. That is the point.

Miss Godfrey: In principle we think both these standard deductions ought to go. We say \$50 might be retained simply because administratively it might be such a bind to have all these little receipts to deal with.

Senator Benidickson: They should all be supported by vouchers, except for the administrative overheads.

Mr. Philip: That is right.

Senator Cook: It would be more sensible to do away with both and to raise the limit.

Miss Godfrey: We have said we think the same principle should apply overall. There is no limit for eligible employment expenses in the business and professional field at present. If you can support them and prove them, they do not have any ceiling, so why should those of the wage earners have a ceiling?

Senator Isnor: I think there is a ceiling, is there not, on charitable donations?

The Acting Chairman: Miss Godfrey was dealing with the proposal in the White Paper to allow a standard deduction for employment expenses. What they are saying is that there should be no standard deduction, and no limit either, but if a person can prove it costs them \$300 they should be allowed to make the claim.

Senator Aseltine: We have had other briefs on the same subject and along the same lines.

The Acting Chairman: Yes, I think James Richardson and Son made the same point. The Welfare Council make a specific point on the retention of the 10 per cent limit on the deduction of donations. I wonder if you could amplify that, because I do not think anybody else has made that suggestion.

Mr. Philip: I would say we took the view that the deduction from income should be for charitable donations made out of income, and that we did not think that in all equity—because we tried to look at it with a balanced view—that payments out of capital to charity should really come into the calculation of taxable income. Secondly, we felt that there was so few people now getting to the 10 per cent level that there was certainly substantial room for most people making charitable donations to increase their donations without coming into contact with the upper limit. I think our view might have been different if we had been substantially greater statistics where people were bumping into that upper limit, and then we would have been prepared to support an increase.

The Acting Chairman: Perhaps I should tell you about an interesting study which I saw recently which

shows interestingly enough that the percentage of income that is given to charity turns on a curve of which the lowest income is zero, and it goes up to an astonishingly low income and then it drops off again as the income goes up into the middle areas even to as high as—and these were American statistics—\$25,000. Then it started to take a very, very deep incline to those fortunate few who are making a million dollars a year. They generally contribute 10 per cent or more of their income. It has been presented to us that the very wealthy feel that they are limited in the amount they can give to charitable undertakings by the 10 per cent rule. So, you are right that outside of the very, very wealthy, the amount they give is probably not near 10 per cent, but the very wealthy are concerned, and I wonder how you feel about that. That is a minority group you might well be concerned about.

Mr. Philip: Consideration might be given to enhancing the role of continuing the carry-over provisions which are now limited to one year, which might soften the blow, as I understand it, and which might enhance the situation. Where they drop off now after one year, the effect of that further carry-over would, I think, be very interesting.

The Acting Chairman: But you say you are concerned about tax avoidance foundations.

Mr. Philip: I think there was some concern in the committee that if unlimited donations were allowed, there certainly might be an opportunity to use this as a means of avoidance where the dollars were at a fairly high level, and where the foundations formed for questionable activities might end up being the recipient of large funds.

Senator Carter: You mention at the bottom of page 31, section 24 the setting up of unjustifiable charitable trusts on a large scale. Can you elaborate on that? Do you have any examples you can give us of unjustifiable charitable trusts? What do you have in mind there?

Mr. Philip: Well, I would think that if we had unlimited deductions, it certainly might involve an incentive to some groups of individuals to form trusts or corporations dedicated to broad charitable activities where the prime reason for making the contributions was not the activity itself but as a tax exemption. The eventual use of the funds might very well not be for the broad general good but more for the adoration of the individual in establishing memorials to himself which might have very limited social value for the broad number of Canadians, but might have real use

for, let us say, extremely wealthy Canadians or a limited group of Canadians.

Senator Carter: Does not the present law require them to spend their income in the whole year now?

Mr. Philip: Yes.

Senator Carter: And they spend it on something not very worthwhile rather than on something necessary?

Mr. Philip: What we are saying is that there would be opportunity to develop charitable trusts which would go on over a long period of time. If the temptation is there, these opportunities may be pursued.

Senator Benidickson: Does not the existence of the 10 per cent ceiling postpone the gifting until death, in many instances? Because on death a gift for charitable purposes would be exempt, therefore someone who has given 10 per cent of his current income decides he will not pay this out of capital because he does not get the use of the funds, and on death it will go tax free.

Mr. Philip: You say that the postponement until death reflects the individual's interest in retaining the use of his assets during his lifetime?

The Acting Chairman: What Senator Benidickson has said is that by the operation of the 10 per cent rule a person who might give away more during his lifetime is forced to postpone doing so until his death.

Mr. Philip: I would not say that. What you are really saying is that if he does not get the income tax benefits he is not going to do the charitable action.

The Acting Chairman: That is probably very true.

Senator Cook: It certainly makes it easier, does it not?

Mr. Philip: I am saying that these are major contributions. Even if there were unlimited deductions and you wiped out the total income, it is unlikely these would be deducted under the present regulations, even without the 10 per cent limit. I would think the hesitancy of making a \$2 million gift to any activity now is more restricted by the person's interest in retaining his assets and using them during his lifetime than by the fact that he can only deduct \$10,000 rather than \$100,000.

The Acting Chairman: What do you think about the deemed realization under the capital gains tax on a gift? Let us assume the gift is a painting to an art gallery. According to our interpretation of the White Paper there would be a deemed realization and a capital gains tax on the residual.

Mr. Philip: I would not like to speak on behalf of the council, because this is an item we did not discuss. I can offer my own personal opinion, however.

The Acting Chairman: We would be pleased to hear it.

Mr. Philip: I do not believe we should have a capital gains tax on gifting, but I think the deductions should be limited to the cost basis.

Mr. Wheeler: There is another aspect of deductions for charitable purposes; they do involve a loss of revenue to the Government, and therefore involve a form of public subsidy. Yet the decision as to how this should be applied is made by an individual and the public has no say.

The Acting Chairman: That was the original rationale for the limit of 10 per cent.

Mr. Wheeler: And so much depends on how the purposes for the donations are defined.

The Acting Chairman: I wonder if we could pass on to the income averaging option. This has greatly concerned the committee.

Mr. Philip: Presumably, if you had the ideal situation, you would have lifetime averaging, and you would then have everybody paying the same tax on the same income, regardless of which year or in what lumps it was received. That is the ideal situation. I suppose it is impractical to develop a structure that would accommodate that type of averaging, so the council felt that the averaging should not only be up but also down. If averaging is equitable, then it is equitable whether the income goes up or goes down. I think we are somewhat concerned at the fact that this averaging situation is held out as a relief whereas in fact, on incomes of \$18,000 and over, it is useless. When you calculate the tax you find there is no difference. So, in looking at the progressivity in the rate structure, our real objective is a system of averaging that is meaningful both up and down.

The Acting Chairman: Perhaps we could tie that in with the capital gains tax. You said that you are fully in favour of the capital gains tax.

Senator Isnor: Did they say that?

The Acting Chairman: Yes, paragraph 53 on page 35. The White Paper proposes to bring capital gains into income and this, in effect, will mean that a gain is taxed at the highest marginal rate, and a subsequent capital loss is taxed at a lower marginal rate. This is due to the operation and the inadequacy of the income averaging provisions, which you have just mentioned. If a loss follows a gain you are in real trouble because the averaging provisions do not work at all. If the gain follows a loss then it works a little better, but not a great deal. Many of the recommendations we have had have been to the effect that the capital gains tax should be a separate tax.

Mr. Philip: I would say that the council had some difficulty in distinguishing between capital gains and income for the purposes of taxation. There are probably some distinctions that are obvious. One is that capital gains are usually earned over a period of time, and if they are lumped into one year they tend to bear a higher average tax than they would otherwise. What concerns us is an improved income averaging provision that would eliminate or substantially reduce this problem.

The question of inflation was discussed substantially, but the provisions for dealing with inflationary gains are extremely difficult because we have to take into account people who have investments in non-inflationary items. Bonds, for example, would provide an example of a deflationary gain. If you are going to eliminate inflationary gains then are you going to allow a discount for the deflationary loss on the bonds? Inflation is a major problem which we have to some extent sidestepped. We do think that capital gains should be brought into income, with an appropriate averaging.

The Acting Chairman: So you do not opt for a separate capital gains tax?

Mr. Philip: No.

The Acting Chairman: Would you find fault with such a tax, even though you do not recommend it?

Mr. Philip: It depends, I suppose, on the basis of the tax, and how it would relate to the taxing of normal

income, which would depend upon having to look at the situation at a given time.

The Acting Chairman: There are all sorts of options. The White Paper says that incomes from widely-held companies will be at half rates; it says that the tax will apply on personal property over \$500 only. There is a standard deduction. It states that in respect of a house there will be a deduction of \$1,000 a year, plus \$150 a year for repairs. So, you can see that while they are imposing incomes rates, by the time all those exceptions are taken into account there is a variety of rates of capital gains taxation.

Mr. Philip: I would think that the variety is not intentional, but results from a recognition of the impracticability of taxing in some situations at the normal rates. Probably I suppose it might be termed an equitable arrangement for allowing reductions on certain kinds of homes which are of special nature.

The Acting Chairman: You do have a specific suggestion on homes or principal residences.

Mr. Philip: Yes.

The Acting Chairman: Perhaps you would like to review that for us?

Mr. Philip: We believe that the rollover provision on homes should be available without the necessity of moving for job purposes to a new location. That is the major aspect of our recommendation on exemptions for the realization of a capital gain on sale of homes. That to qualify, a person has to acquire a home in another area seems to us to be unduly harsh.

Mr. Davis: In fact, we were at a loss to understand why that specific stipulation was made, why one would have to leave one area for another. Supposing that the house is expropriated in a development scheme, you have to move for one reason or another. But why have to move to get the benefit of the rollover?

The Acting Chairman: I think that generally the witnesses before this committee have indicated that they are also at a loss. Someone suggested the rollover provision you suggested. Most suggested the principal residence, that they use the English system, that the principal residence not be subject to tax. You would impose a tax on the final disposition of the residence?

Mr. Philip: That is right.

The Acting Chairman: It seems to me that if you do not have a separate capital gains tax, then it becomes terribly important that you have a very very efficient averaging plan.

Mr. Philip: Certainly a separate rate schedule for capital gains structure would give more flexibility in adjustments without getting into the complicated methods of adjusting that burden.

The Acting Chairman: One of the beauties of a separate schedule as presented to us is that in order to have a separate schedule you would define certain transactions as not being a capital gain, that is, transactions in the ordinary course of business and transactions for short terms. Someone suggested a term under six months, or under a year. On straight speculations, they would automatically be put straight into income and taxed at the highest rates. Only those long-term gains would come under the heading of a capital gain.

Mr. Philip: There are only two comments on that. If you define the transactions, you will have a wealth of cases which attempt to define something as a capital gain as opposed to trading. I do not think there is any clear definition yet in these department practices, whether when somebody asks if a particular item is a capital gain or a trading matter it is very difficult to answer.

The Acting Chairman: Of course it is.

Mr. Philip: Secondly, if you put a time limit on it, you will have restrictions on commercial actions to get over that time limit. If it is two years, you sell the land in two years and a day rather than in eighteen months. Then the game begins, "I will sell you that land this week but title does not change until January 1st, because that is my two years."

So, when you start imposing time limits you start getting into that type of situation.

The Acting Chairman: Our counsel has just leaned over to me and said that that was a very good answer, and I agree.

The last point I would like to take up with you is item 55. It is the first time I have seen the point brought forward, the withholding tax on low income people. It is a most interesting point.

Senator Benidickson: It is a very interesting point but administratively it might be difficult, because a

man who disburses the payment has the obligation to remit and he would not know the personal rate of the person to whom he pays. Say it is a company sending a pension cheque, the company would not know the personal income tax rate of the recipient abroad.

Mr. Philip: We were quite concerned about the White Paper in paragraph 1.46 where it said:

Pensions paid from Canada to persons living outside would be subject to a withholding tax of 25 per cent, but with provision for lower or higher rates if the circumstances of the recipient warrant.

If that really means that they are going to try to get the person's personal tax position, then the minister in the White Paper has said exactly what we have in our presentation. We just want to make sure that the committee realizes that is what he said. So we do not think that is a new suggestion; we are just parroting his rather vague proposal.

The Acting Chairman: Have you any further points you would like to bring up at this time?

Miss Godfrey: I wonder whether this committee is interested in our comment on the question of medical expenses.

The Acting Chairman: That was that the medical expenses not covered by a plan be deductible?

Miss Godfrey: Yes.

The Acting Chairman: Yes, I think we would be interested. For the purposes of the record, you could go over the suggestion again.

Mr. Philip: The minister, over the years, has grudgingly added to the listing of deductible items, and we realize the administrative problems in expanding that deductible group. But there is an artificial line between deductible and non-deductible items, and when it comes down to the person who has to pay the cost of the omitted items, the easing of administrative problems is little compensation. We are concerned that a fresh review of the items included in that list be made to ensure that all medical expense are taken in to account and not just the ones that have the limited definition "might be assisted under federally or provincially supported medical plans."

The Acting Chairman: That is a sound suggestion. Are there any other points?

Mr. Davis: There is one little point that we passed over. I mention it because of the Senate Committee on Aging and the important contribution I think the Senate made through the introduction of a guaranteed income supplement for aged people. I think the Senate still continues its interests in that group of the population. You will notice that our brief, on page 29, suggests taking away the \$500 exception that old people now enjoy. I did not know how that would ride with the Senate that has been fighting in the interests of older people, and I would personally hope that the \$500, although it benefits only a small fraction of older people, would not be withdrawn without a quite specific provision for increased benefits to old people. I think it is a crying shame that escalation of Old Age Security is going on at a rate of 2 per cent when the cost of living is going up at at least twice that rate.

Senator Benidickson: The White Paper has delayed it.

Mr. Davis: That is right. I would suggest you use that \$500 as a bargaining point, to get an escalation of the Old Age Security and to get your guaranteed income supplement, which is really a Senate innovation, not at 40 per cent, but at 60 per cent of the basic Old Age Security.

I feel the condition of old people in this country is past the time when something should be done for them. So, while I am supporting the council's position on the \$500, I would not give that up without getting a concession that would benefit them.

The Acting Chairman: I thought that is what they did say here.

Mr. Davis: It is not very specific.

The Acting Chairman:

A more satisfactory substitute should be instituted: for example, through increased old Age Security and for guaranteed income supplement payments.

But you are using the specific of 60 per cent.

Mr. Davis: I have this in mind, because to some extent I was connected with your Committee on Aging, and your committee at that time spoke of itself as a watchdog with a continuing concern for the old people of this country. I think it is time to get into action on this matter.

The Acting Chairman: I know that Senator Croll, Chairman of the Special Senate Committee on Poverty, has mentioned that very fact several times. I feel certain that it will not escape his notice when he comes to write his report.

Senator Cook: Why not have both this and the \$500 exemption?

Mr. Wheeler: The \$500 will not benefit more than 10 per cent or 15 per cent of old people. Over 50 per cent of the total qualify for the guaranteed income supplement, which means they do not have any income to declare. When the exemption level is raised to \$1,600, there will not be many old people filing income tax returns.

The Acting Chairman: Are there any further points that you would like to bring out? Are there any further questions, honourable senators?

Senator Carter: I would like to ask, without spending time on an answer now, but one of the witnesses raised an interesting point with respect to the exemption starting out as \$1,000 and being now \$1,400, which are both arbitrary figures.

Would the Research Director write us a letter with some guidelines as to how that figure should be developed, what it should be and what factors should be taken into account when considering it?

Senator Benidickson: The \$1,000 emerged as a justified exemption. However, we were not consistent in view of the fact that the cost of living has risen more since 1949 than has the proposed exemption of \$1,400. If the \$1,000 was valid it should be \$1,600.

Senator Carter: If we are to have a realistic figure, it should be based on something. We do not know what this is based on, but if you were to determine this, what factors would you take into account?

Mr. Racine: We are agreeable to writing such a letter.

The Acting Chairman: Gentlemen, on your behalf I would like to thank our witnesses and you, Mr. Racine.

It has been most interesting. Many of the points that you have brought forward have not come to our attention before. I can assure you that the viewpoint that you have given, in contrast to most of the witnesses we have had to this point, is different.

The committee adjourned.

APPENDIX "A"

CANADIAN PULP AND PAPER ASSOCIATION

SUBMISSION ON

PROPOSALS FOR TAX REFORM

MARCH, 1970

SUMMARY

The Canadian Pulp and Paper Association believes that tax reform is needed in Canada as a means of achieving greater social justice and that this goal can best be achieved by changes that will improve the country's economic performance.

A number of the Proposals for Tax Reform would improve the distribution of the tax burden. Some others would provide incentives by reducing marginal rates and allowing reductions for expenses incurred in earning income. Such proposals would have a stimulating effect on economic growth and we support their adoption.

There are, however, a number of proposals in the White Paper that would be adverse to economic growth, for they would reduce savings and incentives to work and invest in Canada. These we oppose. In addition, many of the provisions in the White Paper would greatly complicate the administration of taxes and prove costly to the government and the taxpayers. The Association suggests that, in these instances, simpler and less costly procedures be adopted.

The need to improve the competitive position of Canada is evident. Tax policy offers a means for doing so. It is, therefore, recommended that tax reform be designed specifically to accomplish

this goal and to take a positive approach to fostering economic development. The following recommendations would be a powerful stimulus to growth and the Association urges their adoption.

1. As proposed in the White Paper, the exemptions on personal income should be increased to provide relief to low income earners, and the top marginal rate reduced to 50 per cent to provide needed incentives. The marginal rates on so-called middle-income groups should not be raised, as already they are too high to provide optimal growth in the economy.
2. To improve the competitive position of the Canadian industry, the rate of tax on corporate income should be reduced. It should be at least as low, and preferably lower than the United States rate, and in addition, tax incentives should be used, where required to be competitive.
3. To eliminate double taxation of income flowing through corporations, there should be full integration of personal and corporate income by means of a tax credit.
4. We oppose the taxation of capital gains in principle, particularly for Canada at this stage of its development, and the proposal to tax them should not be adopted.
5. The value-added tax has been adopted by members of the European Economic Community and is being considered by the United States. As this development adversely affects our competitive position in export markets, the use of this tax by Canada to overcome these effects should receive careful review.

6. Capital cost allowances have an important impact on corporate cash flow, and should be considered along with other proposals.

The foregoing, if enacted all at once, would result in a decrease in government revenue of about \$1.7 billion. However, a plan to stage their introduction and to adjust other taxes and expenditure programmes would make their adoption easily manageable. Increased economic growth would result in higher gross national product that would more than offset this revenue reduction in about five years.

Tax reforms of this nature should be given high priority among government programmes aimed at improving the economy, and the Association suggests that these recommendations be considered as a modification to those of the White Paper.

Standing Senate Committee

CANADIAN PULP AND PAPER ASSOCIATION

SUBMISSION ON

PROPOSALS FOR TAX REFORM

MARCH, 1970

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I. INTRODUCTION

Because of the richness of its resources, both human and material, Canada has an excellent potential for rapid economic growth. The realization of this potential would bring higher levels of personal income across all income ranges, and much expanded tax revenues. It is the view of the Canadian Pulp and Paper Association that the "Proposals for Tax Reform" seriously under-estimate the significance of this process; that they treat far too lightly the importance of economic growth in providing higher living standards and better social services for all Canadians.

The generally accepted economic goals for Canada are full employment; a high rate of economic growth; reasonable stability of prices; an equitable distribution of rising incomes; and a viable balance-of-payments. Yet these objectives can be achieved simultaneously only in an environment which promotes saving and investment and provides incentives to work. Attempts to redistribute income that limit the creation of income are bound to be self-defeating.

This Association believes that tax changes aimed at improving economic performance as the means of achieving greater social justice are needed in Canada. Our submission, therefore is chiefly devoted to the economic effects of tax policy. As certain of the proposals in the White Paper would have a major detrimental effect on the attainment of a high level of economic growth, we suggest herein a series of modifications.

Economic Prospects of the Canadian
Pulp and Paper Industry

The Canadian pulp and paper industry makes a very important contribution to the Canadian economy. Indeed, it is the nation's leading manufacturer, and largest industrial employer. Its shipments last year amounted to 18-1/2 million tons of which nearly 15 million tons valued at \$2.0 billion were exported. In addition, the industry supplies the paper and paperboard requirements of the Canadian economy which took over three million tons of product last year and which accounts for an important percentage of total industry shipments.

The prospects for this industry are very promising if we are able to capitalize on the opportunities now available to Canada.

According to the Food and Agriculture Organization of the United Nations, world consumption of paper and paperboard was 112 million metric tons in 1968. It has been forecast to rise to 163 million tons in 1975 and to 205 million tons in 1980, or at a rate of 5 per cent per year. Canada has vast reserves of timber which would enable it to participate in this growth. The National Forestry Conference in 1966 estimated the allowable cut to be more than twice as high, on a sustained-yield basis, as the present cut under present-day forest management, and more than three times as great under more intensive management.

In the last ten or fifteen years, despite the availability of fibre, our share of world markets in total has been approximately unchanged. Thus, attainment of an increased share will require improved performance. Based on the resource situation, there is great interest in Canada as a site for additional pulp and paper

production. This is, however, offset by high levels of costs and taxes which result in returns on investment in this industry that are insufficient to justify the heavy expenditures now required for new mills. There has been a steady decline in the rate of return in recent years. If we are unable to reverse this situation, investment capital may be directed elsewhere, to the cultivated forests in more productive areas which are now being exploited, such as the United States and South America; or to tropical forests that so far are practically untouched. Already, the Japanese industry is importing chips from tropical woods for manufacture and is vigorously searching out further opportunities.

Obviously, productivity in our industry must be improved, as it must in industry generally in Canada. Also, we must have an improved economic climate in which to operate, a basic determinant of which is the tax burden. Large amounts of capital will be needed to provide for greater capital-intensity in the mills and greater mechanization of woodlands operations, as well as the installation of additional capacity. The industry will also require closer ties with users in other countries. This will occur both by foreign companies investing in mills here and by Canadian firms investing abroad. Thus, not only large amounts of capital but also the unimpaired flow of capital to and from Canada is essential for the development of the industry. The effects of the tax proposals on the competitive position of this industry are outlined in the following sections. These comments apply, we believe, not only to the pulp and paper industry, but to Canadian industry in general. All Canadian industries will be affected by proposals which have an impact on the competitive position of this country as a place to carry on business.

II. THE ECONOMIC EFFECT OF THE
WHITE PAPER PROPOSALS

This Association recognizes the need for change in our tax system to keep pace with developments in a dynamic economy. In devising these changes, first priority should be given to the attainment of rapid economic growth. A tax system designed to attain a significant increase in the rate of economic growth by a specified time would be very different to that presented in the White Paper.

We submit that the effect of the tax proposals on economic development has not been adequately researched. Furthermore, the proposals now being considered relate only to personal and corporate income. The incompleteness of information presented in the White Paper makes it very difficult to appraise its full meaning. Thus, we recommend that further evaluation of the economic effects of the proposals, including possible changes in sales and excise taxes and estate duties, be carried out before any changes are decided upon.

The White Paper comments briefly on the economic effects of its proposals. Generally speaking, its view is that the changes will have little effect and, in any event, that any adverse effects can be offset by normal adjusting mechanisms or by changes in fiscal or monetary policy. The background studies on which these views are based, if there are such studies, have not been made available for review. We question the view that the adverse effects will be only minor.

The White Paper states that the impact of increased marginal rates on income do not seem large enough to change work patterns to any marked degree. We submit that this assessment may very well be

wrong and that initiative and work performance could certainly be eroded. Again, the higher tax burden to be borne by the so-called middle-income group would, according to the White Paper, detract from Canada's ability to retain and attract skilled people, and the solution put forward is for Canadian companies to meet the increased burden with higher rates of pay. But Canada already has difficulty in retaining skilled people; compounding this problem would surely be to the detriment of development.

The White Paper estimates that the proposals which affect saving would reduce the flow of savings by \$525 million by the fifth year. It does not comment on the effect of such a reduction, but it seems to imply that it is not important. We submit, however, that this amount is significant, particularly in view of the needs for investment in Canada, and its absence would restrain investment and growth to an important degree.

With respect to the return on investment, the White Paper states that, although there are offsetting factors, the over-all result of its proposals would be a reduction. Again, we believe this to be a detriment to the economy.

Non-resident investors in Canada will be affected in several ways but the White Paper states that the changes are not expected to cause any substantial reduction in foreign investment in Canada. Since none of the proposals are favourable to non-resident investors and a number are unfavourable, the effect must be detrimental to foreign investment, a development which would have immediate adverse affects.

The statement that reduced private saving and reduction in capital expenditures by closely-held companies and the mineral industries

would be offset by an increase in government revenue is difficult to understand. In fact, these two items are not offsetting; increased government revenues are not a substitute for private saving in their impact on development.

Finally, the White Paper assumes that the balance-of-payments position should be modestly improved by the proposals. Convincing arguments for this statement, however, are not presented and unless the competitive position of Canada is improved, deterioration of the balance-of-payments situation is a distinct possibility.

An additional and serious shortcoming to the economic evaluation given in the White Paper is that it seems to assume that the present level of performance of the economy is ideal, or at least satisfactory. Few people would agree with such an assumption. The potential for Canada is much greater than our attainments so far, and we should be devising a tax system that would lead to improved performance. Tax reform should take a positive approach toward economic development of the country.

A high level of economic performance in Canada will require a high rate of investment and thus a high rate of saving; high rates of participation in the labour force and strong motivations toward work; and a strong export performance to support the balance-of-payments position. A tax system designed to bolster all these elements should be an essential part of Canadian economic policy.

The White Paper indicates that after the changes it proposes have been fully implemented, government revenues, on the basis of 1969 income levels, would increase by some \$630 million. We agree, of course, that essential government expenditures should be provided for,

but surely tax reform should not provide for increased revenue. To improve the competitiveness of the Canadian economy the tax burden should be reduced. Such a policy, by fostering economic growth, would result in a broader tax base and an increase in the absolute level of government revenues.

III. RECOMMENDATIONS

Our suggestions for tax reform emphasize economic growth. Those of the White Paper, taken as a whole, are detrimental to growth. We suggest, therefore, the following modifications in order to make the tax system operate in support of the rapid development of the economy:

1. As proposed in the White Paper, the exemptions on personal income should be increased to provide relief to low-income earners, and the top marginal rate reduced to 50 per cent to provide needed incentives. The marginal rates on so-called middle-income groups should not be raised, as already they are a disincentive to optimal growth in the economy. Furthermore, they should be set at levels that will retain managerial and technical people in Canada. It is wasteful for Canada to spend large sums educating skilled labour for export.

2. To improve the competitive position of Canadian industry, the rate of tax on corporate income should be lowered. It should be at least as low and preferably lower than the rate in the United States. In addition, tax incentives should be used, where required to be competitive.
3. To eliminate double taxation of income flowing through corporations, full integration of personal and corporate income tax should be introduced, ie., income flowing through widely-held and closely-held corporations should be treated the same. This should, however, be accomplished by increasing the dividend tax credit to avoid the many disadvantages of the creditable tax provision.
4. The proposal to tax capital gains should not be adopted at this time. We oppose it in principle because it is a tax on capital, which Canada can not afford at this stage of development. Furthermore, the White Paper has not proved that adoption of this tax would accomplish the main purpose of taxation, ie., the raising of substantial revenues in an efficient way. Details as to our views on this tax are presented in Section IV.
5. The value-added tax has been adopted by members of the European Economic Community and Canada should give careful study to its use. This tax, as it is abated on exports, will have a serious effect on our competitive position vis-à-vis those countries in world markets.

It must be pointed out that the United States government is already considering altering its tax structure to compensate for this development, making it doubly important for Canada to give early attention to it.

6. Capital cost allowances have an important impact on corporate cash flow, and should be considered along with other proposals. Present regulations and recapture rules are not overly generous. Rates for special purpose industrial buildings should be increased, and provision made to write off the balance of obsolete facilities.

The foregoing proposals would result initially in a decrease in tax revenue. While lack of available data precludes a precise estimate, we estimate the reduction at some \$1,670 million, based on 1969 income levels, made up as follows:-

	<u>Million \$</u>
Increased basic exemptions	- 1,000
Increased allowances	
employment expenses	- 235
child care	- 95
Top rate of 50% on personal tax	- 40
Reduced amount subject to low rate of corporate tax	+ 300
Lower rate of corporate tax (5 points)	- 300
Full integration of corporate and personal tax through tax credit	- 300
	<u>\$1,670</u>

These proposals would be, however, a powerful stimulus to growth. They would increase the gross national product and,

subsequently, government revenues above the levels that would be attained either by the present tax system or the system proposed by the White Paper.

Because of the revenue implications of the proposals, a plan for introducing them along with other fiscal programmes could be drawn up providing for their adoption by a specified date, say, five years. Presentation of the plan and immediate reduction of taxes would increase the rate of economic growth. As tax rates move toward the planned levels, the growth rate would increase further.

It would not be unreasonable to assume that such a policy could result in an increase of about 1-1/2 percentage points in our rate of economic growth. That is, if the attainable growth rate in real terms under present policies is 4.5 per cent per year, a 6 per cent rate might be achieved with the system we propose. Applying the higher rate to the 1969 gross national product of \$78 billion, would result in an increase of \$7.2 billion in annual GNP by the fifth year over the level attainable at the lower rate. This increase would provide a base for additional government revenue which would more than compensate for the lower rates of tax.

Present tax rates are generating a budget surplus. It is unlikely that stabilization policy will require the continuation of a surplus of current size. This provides an opportunity for reducing taxes in ensuing years. Moreover, should the proposals not meet revenue needs in the first year or two, the sales tax base could be broadened to provide additional revenue.

We suggest that these proposals be considered as a realistic modification of the proposals in the White Paper. Lowering the burden of taxation should be considered as a specific economic policy to improve Canada's competitiveness and enhance its economic performance. It should be given high priority among other economic policies for the country.

IV. DETAILED COMMENTS ON THE WHITE PAPER TAX PROPOSALS

1. The Effect of the Tax Proposals on the Supply of Investment Funds

Improved economic performance of the pulp and paper industry and of the Canadian economy will require large supplies of capital. The following comments are made in this context.

(a) Integration of Corporate and Personal Income Taxes

We support full integration of corporate and personal income taxes. This principle was advanced in our submission to the Royal Commission on Taxation and recommended in the Commission's report.

We do not agree with the proposal for only partial integration. In its defense, the White Paper implies that some level of the corporation tax may be passed on to customers. The Report of the Royal Commission stated that while this may sometimes be true, it is not a valid objection to full integration. Furthermore, taxes cannot be passed on

to customers by export industries; their prices must be competitive with those of suppliers in other countries.

The White Paper suggests, as a second reason for not allowing full integration, that the proposed rate of tax on corporate income seems reasonable and competitive relative to rates in the United States and United Kingdom. This argument is not relevant. Failure to allow full integration means continued double taxation of corporate income. The Royal Commission Report stated that full integration would reduce the cost of equity capital and increase capital spending. These aims are definitely in the national interest.

While we favour the principle of integration, there are serious practical disadvantages to the White Paper's proposed method of achieving it which will greatly complicate the administration of business. The result will be that tax credit effects will have to be taken into account in all business decisions, entailing major costs.

The White Paper has not given sufficient consideration to companies having fixed dividend shares, or more particularly, large widely-held companies in which the shareholders expect annual dividends. These companies will have little or no taxable income during and immediately following a major expansion, yet they will continue to pay dividends. The result is that no creditable tax will be available immediately. Ultimately, excess creditable tax will be generated but will be of no advantage to the shareholders unless the company alters its dividend policy.

In the case of closely-held companies, the proposal that no tax credit be given for potential depreciation recapture amounts to a retroactive tax. It is suggested that, if the problem is a serious one and requires special provision, the non-creditable tax should apply only when the depreciation recapture is realized.

With respect to the 15 per cent tax on pre tax-reform surplus, it is assumed that it applies only to distributions to individual shareholders, although the White Paper does not specifically state this. However, if it is intended to apply it to dividends from subsidiaries to parent companies, we submit that it only be applied to designated surplus.

The White Paper is silent on the treatment of loss carry forward or back in respect of non-creditable tax. It is understood that where dividends have been paid utilizing all creditable tax a loss may not be carried back to recoup any part of the non-creditable tax. Also, where a loss carry forward offsets the entire taxable income for the current year, there is, obviously, no creditable tax. The 2-1/2 year period for creditable tax to be paid to shareholders is entirely inadequate to overcome these difficulties.

The creditable tax system also detracts from the use of capital cost allowances as incentives, since the credit allowed would be very small in years of high depreciation. If a company which is part of a chain has a lower rate of tax on income, this advantage will be eroded during the process of transferring the income through other companies and to the

shareholders. The proposed system can result in tax rates as high as 75 per cent under certain corporate organizations. The calculations presented in Appendix I and prepared by Bowaters Canadian Corporation Limited show that the tax on corporate income would be 68 per cent in one case and even higher in another.

To provide for fair taxation of income earned through corporations we recommend full offset by means of a dividend tax credit. This would meet the aims of equitable taxation while being much simpler and less costly to administer.

It has been argued that this may allow credit for taxes not actually paid. In the short term, this could in theory occur as, in a particular year, corporate taxes equal to the tax credit allowed shareholders may not be paid. Nevertheless, this is not a significant issue. For in later years taxes paid by the corporation will be greater than the credit allowed. The White Paper centres its arguments on the difference between book income and taxable income, but these tend to equalize over a period of time.

A system that is simpler and would cause less interference with business decisions than that proposed seems justified. Allowance of tax credit would accomplish this at no risk of reduced tax revenue.

(b) The Taxation of Capital Gains

Following publication of the report of the Royal Commission on Taxation, this Association objected to the Commission's proposal to tax capital gains, contending "that it would retard

capital formation at a time when an increased supply of investment funds is needed to achieve maximum growth of the economy." We remain concerned at the adverse effects of a capital gains tax on Canada's growth and development, particularly if it were imposed at a time of severe inflationary pressures in the economy.

We welcome the rejection by the government of the proposition that "every increase in economic power, no matter what its source, should be treated the same for tax purposes." Still, we believe the White Paper reflects misconceptions as to the difference between cash flows that can legitimately be classed as income and those which merely reflect a change in the money value of the nation's stock of real assets.

With respect to the first category, efficient operation of the tax system requires that situations be prevented where cash flows resulting from the expenditure of effort or the employment of capital, and thereby meeting the definition of income, avoid payment of tax. We believe, however, that the solution to this problem is already provided by the present statutes and can be handled by regulation and adequate policing. The imposition of a capital gains tax merely to ensure that all such income flows are brought into the tax net would impose accounting and administrative burdens out of all proportion to the possible gain in revenue.

The White Paper is not on sound ground when it proposes to tax increases in the money value of accumulated wealth. To do so will reduce the nation's capital stock and therefore its ability to produce income (and, incidentally, income taxes)

in the future. The absence of a capital gains levy has increased the willingness of investors to employ their funds in the Canadian economy - particularly in the risk ventures which this country must seek out if it is to achieve maximum growth and development. The taxation of capital gains when these ventures are successful will tend to divert funds into safer forms of investment or into opportunities in other parts of the world where prospective payoffs are more rewarding. Moreover, because capital gains are frequently bunched, they will tend to push the taxpayer temporarily into a high tax bracket, thereby violating the principle of equity. Provisions for income averaging are not adequate to overcome this problem.

It is believed that increases in the general price level have contributed a very large percentage of the historical increase in capital values. To tax gains arising from inflation is to transfer wealth to the government, and is strongly discriminatory against those who save. It is doubtful that the interest in a tax on capital gains would be as keen if the last two decades had witnessed a downward trend in price levels.

The proposal to tax unrealized gains in share value of widely-held companies every five years is particularly onerous. This proposal would be a serious deterrent to closely-held companies going public. Periodic taxation of share values would, in many cases, require the sale of shares to meet tax

liabilities and could result in loss of control of a company. Thus an important method for raising capital, the issuing of shares to the public, is made much more difficult.

It is believed that the revenues from taxation of capital gains will be relatively small - significantly smaller than the estimates given in the White Paper, provided rampant inflation does not continue. On the other hand, substantial collection costs will be incurred by the government and by taxpayers. Corporations will be put to considerable expense and trouble to value their assets on the proposed valuation day, as will citizens. In addition, the taxation of capital gains by non-residents will deter investment in Canada.

We do not believe that the imposition of a capital gains tax would be an important contribution to equity. In view of its undesirable effects, and its administrative costs, we suggest that its imposition be delayed until such time as it may be possible to justify it with better information than is now available, and until the government succeeds in achieving price stability in the economy.

Should the government, nevertheless, decide to impose a capital gains tax, for whatever reason, the methods proposed by the White Paper are far too stringent. It would be preferable to designate a type of income subject to this tax and to tax it at a rate substantially lower than the top rate on income and, again for competitive reasons, at a rate lower than is applied in other countries. Possibly there could be an allowance, graduated according to the time

the asset was held. A high percentage of a gain realized on an asset held for only one year could be included in income and a smaller percentage for each subsequent year. The lowest rate would apply to assets held for five years or more.

The proposal to tax gains on the sale of personal tangible property and principal residences is unfair and will cause widespread discontent and ill-will. Proceeds from the sale of these types of property should not be taxed. Moreover, there should be no tax on unrealized gains. With respect to valuation, guidelines as to acceptable methods of valuation will have to be established, adequate time to determine values acceptable to the government should be allowed and a target date for establishment of these values should be set.

(c) Proposed Changes in the Rate Structure
on Personal Incomes

The increased exemptions allowable on personal income and the reduction in the top marginal rate of tax on personal income are sound proposals. However, the proposed rate of progression of taxes will impose an increased burden on the so-called middle-income group, and this the Association opposes. At the same time, the narrow spread in tax brackets will result in increased tax rates arising solely from inflation and thus a transfer of real income to the government. The steep progression proposed will subject people of relatively modest income to high rates of tax. The increase in the rate of taxation is, apparently, proposed in the name of equity but convincing arguments to support

this stance are not presented. Rather than equity considerations it is more likely that the higher rates are in fact required to offset reductions in revenue resulting from other changes in the rate structure.

We agree with the White Paper's argument that high rates of taxation would lead to slackening of effort and would reduce Canada's ability to compete with other countries for the services of people of outstanding ability. Already, rates of taxation here are higher than in the United States. A widening of the differential will make Canada less attractive for the highly-trained. Undoubtedly it would result in increased emigration of such people. This aspect may affect most strongly our young men and women, who seek out opportunities wherever they may be. Probably we would also see a decline of interest in moving to Canada amongst skilled people in other countries. Companies in this Association already have difficulty in encouraging managerial people to come to Canada, partly because of the higher tax burdens here. They are obliged to pay substantial premiums as an encouragement. As shown in Appendix II, taken from a study prepared by Price Waterhouse & Company, United States tax rates, under the Tax Reform Bill passed December, 1969, will be 30 to 50 per cent lower than rates under the proposed system for Canada, using Ontario and two representative states as the basis for comparison. The requirement for Canadian industry to pay higher wages and salaries to offset the increase in rates would weaken our competitive position. And as people

are interested in after-tax income, the increase in marginal rates will add another cost-push to an already serious inflationary situation.

The increased burden on the middle-income groups will reduce the rate of savings in the economy and will transfer resources from investment to consumption. This will retard economic growth. Reductions in taxes on lower income are welcomed. There is, however, no need to tie such reductions to increased burdens for others, especially if these are adverse to the growth of the economy and would result in lower rates of growth of real income of all groups. Policies which would increase the rate of growth of the economy would be much more beneficial than reduced tax rates. In order to attract and retain our highly-skilled people, both the tax burden and the marginal rates of tax should be reduced.

2. Proposals Affecting Competitive Position

(a) The Taxation of Corporate Income

(i) The Level of Tax

Canada must stimulate domestic capital formation and attract sufficient capital from outside to ensure increasing productivity in the economy and increasing value-added to indigenous raw materials. It is therefore essential that the cash flow generated from investment be attractive when compared with results obtainable in other parts of the world. This Association is of the opinion that the level of taxation should not be such as to have

an adverse effect on our competitive position; indeed, tax policy should be used to improve it. To achieve this we believe that it should be a cardinal principle of Canadian policy that the rate of tax on corporate income be lower than that of the major industrial countries, particularly the United States. When we appeared before the Royal Commission on Taxation, we felt that a rate of 40 per cent was appropriate. In view of the scheduled reductions in the rate in the United States over the next few years, we now suggest that the Canadian rate be kept at least as low as and preferably lower than the United States rate.

The rate proposed in the White Paper, when coupled with present provincial corporation taxes and, in the case of three provinces, logging tax, give the following rates on corporate income in the pulp and paper industry:

	Federal	Provincial	Logging* Tax	Total
Newfoundland	40	13	-	53
Prince Edward Island	40	10	-	50
Nova Scotia	40	10	-	50
New Brunswick	40	10	-	50
Quebec	40	12	2-1/2	54-1/2
Ontario	40	12	2-1/2	54-1/2
Manitoba	40	13	-	53
Saskatchewan	40	11	-	51
Alberta	40	11	-	51
British Columbia	40	10	5	55

* Based on present rates and assuming logging tax treated as an expense.

In contrast, rates of tax on integrated forest products companies in the United States are much lower, partly due to special low rates of tax on stumpage profit. The United States Federal tax rate, after elimination of the surcharge in July 1970, will be 48 per cent. The addition of state taxes, which are deductible from income, increase this rate by several points, varying from 0 to 3.5. The average rate for six states in which the forest industries are important is 2 per cent. Offsetting, for integrated forest products companies, is the special low rate on stumpage profit which lowers the rate by some 3 percentage points, giving a total tax burden for such companies of about 47 per cent.

The general corporate tax rates proposed are above present rates in the United Kingdom and rates soon to be in force in the United States. Because of the additional burden of logging taxes in Canada and favourable treatment given logging income in the United States, the proposed Canadian rates for this industry are grossly out of line with those in the United States. Inevitably, such a differential will adversely affect investment in this industry in Canada.

It may be argued that the integration of corporate and personal income taxes obviates the need for concern over the precise rate of corporate tax. The corporate tax credit, of course, does not apply to shareholders

resident in other countries. To the extent that corporate profits related to these foreign-held shares are retained in the business for re-investment in Canada, a lower rate would have a significant positive effect on corporate cash flows. To avoid a mere transfer of tax revenue from the Canadian to a foreign treasury when corporate earnings eventually are distributed to non-resident shareholders, a special equalization tax could recover for Canada any additional corporate tax liability that would otherwise accrue in the foreign country.

(ii) The Use of Tax Incentives

While the White Paper recognizes the need for tax incentives in certain industries, their use is apparently to be greatly reduced. Canada does not have a monopolistic or, in many cases, a preferred position in resources. So the tax treatment in countries offering alternative investment opportunities is an essential factor in investment decisions. The degree of incentive required in specific industries can be fairly readily established, despite the technical complexity of comparing the tax systems of any two countries. Industries operating in export markets are especially affected by tax treatment accorded to their competitors in other countries.

This Association has already expressed to the government its reservations on the manner in which the Royal Commission on Taxation interpreted the neutrality principle. We believe that the Commission's view of neutrality assumes a degree of transferability of resources within Canada that is not realistic. There is no certainty that the resources diverted from an economic activity in which incentives are reduced would be devoted to other more economic production in Canada. It is more likely that such funds would seek opportunities for investment in the same industry in other parts of the world. Tax incentives have served the Canadian economy well and the tax system should include them where they are required. They should be established for a minimum period, say five years, to enable companies to carry out the required planning and development.

(b) Capital Cost Allowances

Capital cost allowances have an immediate direct effect on corporate cash flow, second only to that of the tax rate. It would be preferable to consider them with the package of tax measures, rather than separately as now intended.

The capital cost of most projects is significantly higher in Canada than in the United States partly as a result of sales taxes. With rapidly changing technology in the industry, many plants that heretofore have had a life of twenty to thirty

years might well now become obsolete in a much shorter period.

In general, we favour the declining balance system. However, the present rate for buildings in manufacturing is inadequate to provide for changes and obsolescence and should be increased by approximately 50 per cent. It is recommended that provision be made for taxing special purpose buildings at the rate applied to the machinery they are designed to house, following the practice in the United States. The rates for other buildings and machinery in Classes 8 and 10, while not generous, are probably reasonable for the time being, subject to a provision that a terminal loss could be taken on any factory that has become obsolete and is closed, as if that factory had been a separate class for capital cost allowance purposes. This would provide an incentive to needed modernization of manufacturing facilities.

Liberal treatment of capital cost allowances has been provided as incentives for certain types of investment required to meet national programmes. An example is the two-year write-off allowable for capital expenditures for stream improvement. We recommend that the government continue the liberal treatment of expenditures of this type and that the regulations apply for a minimum of five years to facilitate the planning of investments.

(c) International Aspects

The tax system should provide adequate incentives for export-oriented operations, including overseas subsidiaries, to sustain

a sound balance-of-payments position. There are a number of proposals adverse to this in the White Paper.

The present system whereby foreign dividends enter Canada tax free where a major portion of the foreign corporation's capital is held by a widely-held Canadian corporation should be retained. The changes proposed by the White Paper are of no benefit to the government's revenue and are only required by the integration proposals and to prevent some tax avoidance.

Bona fide overseas operating companies and their passive investment income should not be affected by Canadian tax. All such corporations of significance will have "passive income," not for the purpose of avoiding Canadian tax, but as a normal concomitant of doing business. The Association sees every reason for the government to stop abuse through tax havens but, in so doing, bona fide operations should not be adversely affected.

It should also be noted that the United States is now considering amending its provisions in relation to foreign income on which the Canadian proposal is based, and furthermore, despite those provisions, it has retained its western hemisphere trading corporation to improve its export position.

It seems unlikely that Canada can in fact negotiate tax treaties on many points proposed by the White Paper including:

- (i) The taxation of unrealized capital gains of individuals and corporations.

- (ii) The taxation of a capital gain realized by one non-resident on the sale to another non-resident.

Without acceptance in tax treaties the international proposals are not viable: in any event, they are economically damaging.

3. Other Proposals

(a) Tax Treatment of Business Expenditures

The White Paper proposes to permit a number of expenditures to be deducted from income that at present are not so allowed. We agree with this proposal and believe it will be much fairer than the present system. However, we question the proposed treatment of goodwill. In the first place, this is a tax on capital gain which we oppose in principle as outlined above. In addition, the proposed treatment would tax gains which accrued to the vendor regardless of when he purchased the business or of the value of goodwill at the start of the system. Thus it would, in effect, tax gains which accrued before valuation day. This retroactive feature is contrary to other proposals and should be amended.

(b) Entertainment and Related Expenditures

The White Paper proposes to deny deduction of entertainment expenses, costs of attending conventions, and the cost of membership in clubs. But expenses of this kind are necessary and unavoidable costs of business. Conferences and conventions are important means for exchanging information and for education

and we do not feel that they should be weakened.

Undoubtedly, some excesses occur. However, adequate provisions exist in present legislation to prevent abuse. Management of public companies subject to the scrutiny of shareholders will control this kind of expenditure in the same way as for all cost items. For companies not subject to such scrutiny, the application of similar criteria through inspection procedures will assure compliance.

(c) Pension Funds

The proposed change in rules regarding pension funds would limit investment in foreign securities to no more than 10 per cent of its assets. Pensions are a growing cost of doing business and funds should be allowed adequate scope to invest in productive assets. The limitation proposed would restrict this scope compared with the present situation and we oppose its adoption.

APPENDIX IEFFECT OF PROPOSED TAX ON CORPORATE DIVIDENDS

In the case of certain companies, the effective rate on taxation of corporate income can be much higher than the proposed 50 per cent which will apply to certain corporate income and to personal income in general. The calculations showing the position of inter-company dividends of the Bowaters Canadian Corporation Limited illustrate the effect of the proposals. The Bowater Paper Corporation Limited, the parent company, is an international company with headquarters in London, England. It carries out its Canadian business activities through Bowaters Canadian Corporation Limited a closely-held wholly-owned Canadian corporation. Bowaters Canadian Corporation, a holding company, in turn owns controlling interest in the following types of companies:

- (a) A widely-held Canadian corporation;
- (b) a closely-held Canadian designated power company;
- (c) a closely-held Canadian corporation.

The White Paper proposals will severely penalize dividends flowing from companies (a) and (b) through to the parent company. Using company (a) as an example, the following calculations show the tax position:

Taxable income		\$100.00
Tax		50.00
		<u>50.00</u>
Dividend to Bowaters Canadian Corp.	50.00	
Plus tax credit	25.00	
Taxable amount	<u>75.00</u>	
Gross tax	37.50	
Less credit	<u>25.00</u>	12.50
		<u>37.50</u>
Less withholding tax 15%		5.625
Dividend received by Bowater Paper Corp. Ltd.		<u>\$31.875</u>

The position of company (b) would be more onerous and the dividend flow-through would be less than shown in the above calculation.

APPENDIX IICOMPARISON OF CANADIAN AND UNITED STATESPERSONAL INCOME TAXES

Total Income	Canadian Federal and Ontario Income Taxes under White Paper	United States Federal and State Personal Income Taxes after Reform	
		Average American Resident New York State	Average American Resident State of Ohio
\$ 8,000	\$ 1,044	\$ 569	\$ 500
10,000	1,658	932	809
12,000	2,327	1,353	1,159
15,000	3,370	2,036	1,708
20,000	5,262	3,345	2,779
25,000	7,434	4,791	3,941
40,000	14,711	10,636	8,786
50,000	19,631	15,202	12,809

Source: Price Waterhouse & Co.

"A comparison of personal income tax burdens: Canada-United States."
Canadian Tax Bulletin, March, 1970.

APPENDIX IIITHE CANADIAN PULP AND PAPER INDUSTRY

For the latest year for which Dominion Bureau of Statistics data are available, the pulp and paper industry ranked first among Canadian manufacturing industries in salaries and wages, employment, value added by manufacture, and selling value of factory shipments. The following are relevant statistics on the industry.

	<u>1969</u> (Estimates)
Number of mills	139
Gross value of production	\$2.8 billion
Pulp and paper exports	\$2.0 billion
Total Canadian domestic exports	\$14.4 billion
Ratio of pulp and paper to total exports	14%
Number of employees	
Mills and offices	73,000
Woods, permanent and seasonal	<u>85,000</u>
	158,000
Wages paid	\$900 million
Capital expenditures	\$350 million
Taxes paid	\$280 million

APPENDIX "B"

NAME: CANADIAN PULP AND PAPER ASSOCIATION

SUBJECT: White Paper Proposals.

Analysis of Appendix "A" by Senior Advisor

This brief is submitted by the Canadian Pulp and Paper Association, a national organization of about 50 companies manufacturing pulp and/or paper and representing more than 95% of the industry. The member companies are located from coast to coast.

The brief submitted by the Canadian Pulp and Paper Association is essentially an economic one. It does however deal with certain specific proposals of the White Paper, these are:

1. Integration
2. Taxation of capital gains
3. Rates of tax, both individual and corporation
4. Incentives
5. Capital cost allowance
6. International income
7. Business expenditures
8. Entertainment and related expenses
9. Pension funds

The attention of the Committee is drawn to the following remarks:

1. "The Canadian pulp and paper industry makes a very important contribution to the Canadian economy. Indeed, it is the nation's leading manufacturer, and largest industrial employer. Its shipments last year amounted to 18 -1/2 million tons of which nearly 15 million tons valued at \$2.0 billion were exported."

(Page 2 of the brief)

2. "We submit that the effect of the tax proposals on economic development has not been adequately researched. Furthermore, the proposals now being considered relate only to personal and corporate income. The incompleteness of information presented in the White Paper makes it very difficult to appraise its full meaning. Thus, we recommend that further evaluation of the economic effects of the proposals, including possible changes in sales and excise taxes and estate duties, be carried out before any changes are decided upon."

(Page 4 of the brief)

3. "While we favour the principle of integration, there are serious practical disadvantages to the White Paper's proposed method of achieving it which will greatly complicate the administration of business. The result will be that tax credit effects will have to be taken into account in all business decisions, entailing major costs."

(Page 12 of the brief)

4. "The White Paper has not given sufficient consideration to companies having fixed dividend shares, or more particularly, large widely-held companies in which the shareholders expect annual dividends. These companies will have little or no taxable income during and immediately following a major expansion, yet they will continue to pay dividends. The result is that no creditable tax will be available immediately. Ultimately, excess creditable tax will be generated but will be of no advantage to the shareholders unless the company alters its dividend policy."

(Page 12 of the brief)

5. "In the case of closely-held companies, the proposal that no tax credit be given for potential depreciation recapture amounts to a retroactive tax. It is suggested that, if the problem is a serious one and requires special

provision, the non-creditable tax should apply only when the depreciation recapture is realized."

(Page 13 of the brief)

6. "With respect to the 15 per cent tax on pre tax-reform surplus, it is assumed that it applies only to distributions to individual shareholders, although the White Paper does not specifically state this. However, if it is intended to apply it to dividends from subsidiaries to parent companies, we submit that it only be applied to designated surplus."

(Page 13 of the brief)

7. "The White Paper is silent on the treatment of loss carry forward or back in respect of non-creditable tax. It is understood that where dividends have been paid utilizing all creditable tax a loss may not be carried back to recoup any part of the non-creditable tax. Also, where a loss carry forward offsets the entire taxable income for the current year, there is, obviously, no creditable tax. The 2-1/2 year period for creditable tax to be paid to shareholders is entirely inadequate to overcome these difficulties."

(Page 13 of the brief)

8. "The creditable tax system also detracts from the use of capital cost allowances as incentives, since the credit allowed would be very small in years of high depreciation."

(Page 13 of the brief)

9. "To provide for fair taxation of income earned through corporations we recommend full offset by means of a dividend tax credit. This would meet the aims of equitable taxation while being much simpler and less costly to administer."

(Page 14 of the brief)

10. "The imposition of a capital gains tax merely to ensure that all such income flows are brought into the tax net would impose accounting and administrative burdens out of all proportion to the possible gain in revenue."

(Page 15 of the brief)

11. "Moreover, because capital gains are frequently bunched, they will tend to push the taxpayer temporarily into a high tax bracket, thereby violating the principle of equity. Provisions for income averaging are not adequate to overcome this problem."

(Page 16 of the brief)

12. The proposal to tax unrealized gains in share value of widely held companies every five years is particularly onerous.

(Page 16 of the brief)

13. "It is believed that the revenues from taxation of capital gains will be relatively small - significantly smaller than the estimates given in the White Paper, provided rampant inflation does not continue. On the other hand substantial collection costs will be incurred by the government and by taxpayers. Corporations will be put to considerable expense and trouble to value their assets on the proposed valuation day, as will citizens. In addition, the taxation of capital gains by non-residents will deter investment in Canada."

(Page 17 of the brief)

14. "Should the government, nevertheless, decide to impose a capital gains tax, for whatever reason, the methods proposed by the White Paper are far too stringent. It would be preferable to designate a type of income subject to this tax and to tax it at a rate substantially lower than the top rate on income and, again for competitive reasons, at a rate lower than is applies to other countries."

Possibly there could be an allowance, graduate according to the time the asset was held."

(Pages 17 and 18 of the brief)

15. "The proposal to tax gains on the sale of personal tangible property and principal residences is unfair and will cause widespread discontent and ill-will. Proceeds from the sale of these types of property should not be taxed."

(Page 18 of the brief)

16. "The increased exemptions allowable on personal income and the reduction in the top marginal rate of tax on personal income are sound proposals. However, the proposed rate of progression of taxes will impose an increased burden on the so-called middle-income group, and this the Association opposes."

(Page 18 of the brief)

17. "We agree with the White Paper's argument that high rates of taxation would lead to slackening of effort and would reduce Canada's ability to compete with other countries for the services of people of outstanding ability. Already, rates of taxation here are higher than in the United States. A widening of the differential will make Canada less attractive for the highly-trained."

(Page 19 of the brief)

18. "The increased burden on the middle-income groups will reduce the rate of savings in the economy and will transfer resources from investment to consumption,"

(Page 20 of the brief)

19. "The general corporate tax rates proposed are

above present rates in the United Kingdom and rates soon to be in force in the United States. Because of the additional burden of logging taxes in Canada and favourable treatment given logging income in the United States, the proposed Canadian rates for this industry are grossly out of line with those in the United States. Inevitably, such a differential will adversely affect investment in this industry in Canada."

(Page 22 of the brief)

20. "While the White Paper recognizes the need for tax incentives in certain industries, their use is apparently to be greatly reduced."

(Page 23 of the brief)

21. "Tax incentives have served the Canadian economy well and the tax system should include them where they are required. They should be established for a minimum period, say five years, to enable companies to carry out the required planning and development."

(Page 24 of the brief)

22. "Capital cost allowances have an immediate direct effect on corporate cash flow, second only to that of the tax rate. It would be preferable to consider them with the package of tax measures, rather than separately as now intended."

(Page 24 of the brief)

23. "The tax system should provide adequate incentives for export-oriented operations, including overseas subsidiaries, to sustain a sound balance-of-payments position. There are a number of proposals adverse to this in the White Paper."

(Pages 25 and 26 of the brief)

24. "The present system whereby foreign dividends enter Canada tax free where a major portion of the foreign corporation's capital is held by a widely-held Canadian corporation should be retained. The changes proposed by the White Paper are of no benefit to the government's revenue and are only required by the integration proposals and to prevent some tax avoidance."

(Page 26 of the brief)

25. "Bona fide overseas operating companies and their passive investment income should not be affected by Canadian tax."

(Page 26 of the brief)

26. "It should also be noted that the United States is now considering amending its provisions in relation to foreign income on which the Canadian proposal is based, and furthermore, despite those provisions, it has retained its western hemisphere trading corporation to improve its export position."

(Page 26 of the brief)

27. "It seems unlikely that Canada can in fact negotiate tax treaties on many points proposed by the White Paper including:
- (i) The taxation of unrealized capital gains of individuals and corporations.
 - (ii) The taxation of a capital gain by realized by one non-resident on the sale to another non-resident.

Without acceptance in tax treaties the international proposals are not viable: in any event, they are economically damaging."

(Pages 26 and 27 of the brief)

28. "The White Paper proposes to permit a number of expenditures to be deducted from income that at present are not so allowed. We agree with this proposal and believe it will be

much fairer than the present system.
However, we question the proposed treatment
of goodwill."

(Page 27 of the brief.)

29. "The White Paper proposes to deny deduction of entertainment expenses, costs of attending conventions, and the cost of membership in clubs. But expenses of this kind are necessary and unavoidable costs of business. Conferences and conventions are important means of exchanging information and for education and we do not feel that they should be weakened."

(Pages 27 and 28 of the brief)

The brief makes the following recommendations:

1. "As proposed in the White Paper, the exemptions on personal income should be increased to provide relief to low-income earners, and the top marginal rate reduced to 50 per cent to provide needed incentives."

(Page 7 of the brief)

2. "The marginal rates on so-called middle-income groups should not be raised, as already they are a disincentive to optimal growth in the economy. Furthermore, they should be set at levels that will retain managerial and technical people in Canada. It is wasteful for Canada to spend large sums educating skilled labour for export."

(Page 7 of the brief)

3. "To improve the competitive position of Canadian industry, the rate of tax on corporate income should be lowered. It should be at least as low and preferably lower than the rate in the United States. In addition, tax incentives should be used, where required to be competitive."

(Page 7 of the brief)

Standing Senate Committee

4. "To eliminate double taxation of income flowing through corporations, full integration of personal and corporate income tax should be introduced, i.e., income flowing through widely-held and closely-held corporations should be treated the same. This should, however, be accomplished by increasing the dividend tax credit to avoid the many disadvantages of the creditable tax provision."

(Page 8 of the brief.)

5. The proposal to tax capital gains should not be adopted at this time.

(Page 8 of the brief.)

6. The value-added tax has been adopted by members of the European-Economic Community and Canada should give careful study to its use.

(Page 8 of the brief.)

7. Capital cost allowances have an important impact on corporate cash flow and should be considered along with other proposals.

(Page 9 of the brief.)

The brief does not lend itself to the preparation of the usual summary of present law, White Paper proposals and principal points of the brief.

APPENDIX "C"

SUBMISSION
OF
BRITISH NEWFOUNDLAND CORPORATION LIMITED

TO
THE STANDING SENATE COMMITTEE
ON
BANKING, TRADE AND COMMERCE
WITH RESPECT TO
THE GOVERNMENT OF CANADA'S
PROPOSALS FOR TAX REFORM

Montreal, Quebec

April, 1970

BRITISH NEWFOUNDLAND CORPORATION LIMITED

This submission has been prepared by British Newfoundland Corporation Limited (BRINCO) and deals with the effects the proposals for tax reform ("White Paper") will have on both resident and non-resident investors in companies engaged in the development of natural resources.

While BRINCO will be affected by many aspects of the proposals, it should be stated, at the outset, that the proposals set out in Paragraphs 4.63, 4.64 and 4.65 of the White Paper, with respect to credits for tax on dividends paid by utilities will result in a very substantial decrease in the after tax income of BRINCO shareholders, whatever their tax position, whereas the White Paper contemplates that integration of corporate and personal taxes should, in most cases, operate to increase after tax income of shareholders in other industries. As a result, shareholders of utilities will be much more heavily taxed than shareholders of other industries. The shareholders of BRINCO will not only bear substantially higher taxes in respect of utility income but will be denied even the partial relief now provided by the 20% dividend credit. The effect of this is so marked that it is hard to conceive of a utility project in which the public would be prepared to invest if the proposals are put into effect. Shareholders locked into existing utility investments will be heavily penalized by the tax proposals unless utility

rates are increased to the customer. In the case of BRINCO this method is not available as power has been sold to Hydro-Quebec for 65 years at agreed prices.

BRINCO is a widely held Canadian resident corporation whose shares are listed on the Montreal and Toronto Stock Exchanges. It has some 20,000 Canadian resident shareholders who hold 40% of its issued shares.

The Canadian resident shareholders are distributed across Canada in ratio to the distribution of population. About 14,000 shareholders hold less than \$1,000 worth of stock each. Thornwood Investments Limited, a closely held Canadian resident corporation holds 49% of BRINCO's issued shares. Thornwood Investments Limited is controlled by the Rio Tinto-Zinc Corporation with Bethlehem Steel Corporation as a minority shareholder. 11% of BRINCO's issued shares are held directly by non-residents.

BRINCO is engaged in developing natural resources in Newfoundland and Labrador through three subsidiary companies:

- (1) Churchill Falls (Labrador) Corporation Limited (CFLCo) is constructing the largest hydro-electric power development in North America at Churchill Falls in Labrador. BRINCO owns

57% of CFLCo. The development will have an installed capacity of more than 7,000,000 horsepower and will have cost an estimated \$950 million on its completion in 1976. After start up, CFLCo will deliver substantially all of its power to one customer, The Quebec Hydro-Electric Commission, under a power contract for a term of approximately 40 years with a renewal for a further 25 years. The availability of this power will enable Hydro-Quebec to supply the Province of Quebec with a substantial part of its power requirements at a price lower than any alternate source.

Approximately 9% of the shares of CFLCo are owned by the Province of Newfoundland and 34% by Hydro-Quebec, neither of which is taxable.

- (2) British Newfoundland Exploration Limited (Brinex) (100% owned) has extensive mineral concessions in Labrador and Newfoundland. It is actively engaged in exploration and operates the Whales Back copper mine in Newfoundland.
- (3) Twin Falls Power Corporation Limited (TFPCo) (33-1/3% owned by CFLCo which holds voting

control) has built and operates a 300,000 horsepower hydro-electric plant to supply power to the iron ore mines in Western Labrador.

BRINCO itself also undertakes studies of potential developments and is currently carrying out engineering and site investigations of a further power site which has a power potential of approximately 2,000,000 horsepower on the Lower Churchill River at Gull Island.

To finance these developments, the BRINCO group has been instrumental in arranging for and providing the following funds:

	<u>Millions of Dollars</u>
Equity Capital	\$ 103
Bonds issued in Canada	150
Bonds issued in the U.S.	590
Line of Credit from Canadian Chartered Banks	150
Mineral exploration expenditures by joint venture partners	3
Earnings and internally generated funds	<u>33</u>
TOTAL	1,029

Of this amount some \$270 million has already been spent on the Churchill Falls Project, approximately \$60 million on the Twin Falls plant, \$7 million on the development of the Whales Back Mine, \$11 million on mineral exploration in Labrador and Newfoundland and \$2 million on site investigation and engineering studies of the Gull Island hydro-electric power site.

As is evident, the impact of the BRINCO group's activities upon the economy of Newfoundland, and indeed of Canada is considerable. This has only been possible because of the faith that lenders and investors have had in the stability and enlightened fiscal and tax policies of Canada. Such investors have been prepared to provide the vast sums of money needed for the Churchill Project in the belief that changes in Canadian tax policy would not subject their investment to more onerous treatment than that applicable to industry in general.

The investment of money in grass-roots mineral exploration is a high risk type of investment. The investor cannot be sure of any return and he has to expect that any return will be delayed for a number of years. Nevertheless, it is only the willingness of investors to take such risks that has made possible the present position of the Canadian mining industry. Our subsidiary Brinex has expended approximately \$11

million in exploration over the past 17 years and together with partners have budgeted for an expenditure of \$3 million during the 1970 season.

The White Paper proposals with respect to taxation of utilities and mining companies, together with the proposed system of tax credits, can only discourage investment in these industries by both residents and non-residents, to the ultimate detriment of Canada.

The rest of this memorandum will deal with the impact of the White Paper proposals on the BRINCO group and its shareholders in relation to utility income derived from CFLCo. The effects of the White Paper on the activities of Brinex, whilst they cause us serious concern, are similar to the effects on other mining and exploration companies and have been dealt with fully by others. The effects on CFLCo are, we believe, unique, and so extreme as to merit the special attention of the committee.

Effects of the White Paper proposals upon BRINCO and its shareholders in relation to income derived from CFLCo.

CFLCo is a utility company and is particularly affected by Paragraphs 4.63, 4.64 and 4.65 of the White Paper and the amendment relating to utilities announced by the Minister of Finance in the House of Commons on 28 November 1969.

Existing tax system:

The present tax position of CFLCo as a public utility is as follows.

CFLCo would pay both federal and provincial income taxes, at the full rate applicable to public utility income. Under the Public Utilities Income Tax Transfer Act, the federal government would transfer to the Province of Newfoundland 95% of the federal tax collected (with the exception of the 3% Old Age Security Tax). In addition, all the provincial tax collected on Newfoundland's behalf is transferred to the Province. The Province of Newfoundland has agreed to rebate to CFLCo the amount of all taxes received by it in excess of 22.5% of CFLCo's taxable income. Such rebate would be tax free to CFLCo under the provisions of the Public Utilities Income Tax Transfer Act. In the case of CFLCo the price of power which has been charged to Hydro-Quebec has been reduced by the full amount of the rebate. CFLCo is, therefore, merely the vehicle through which the rebates are passed on to the consumers of power.

To understand the reasons for this rebate arrangement, it must be appreciated that provincially owned utilities pay no federal or provincial taxes. It has been the policy of successive Governments of Canada to remove this advantage of public owned utilities over investor owned utilities. An example of the operation of this policy is the Public Utilities Income Tax Transfer Act of 1966.

It is only because of the actions of the federal and provincial governments in matters such as this, and the provisions of the Income Tax Act with regard to capital cost allowance, that CFLCo has been able to raise the very large amounts of capital necessary for the development of the project without pushing the price of power beyond a reasonable level and without recourse to the use of government monies. In the case of CFLCo, the full benefits of the tax rebates to be received have been passed on to the consumer of power, in the manner contemplated by the Federal Government when the Public Utilities Income Tax Transfer Act was passed.

Under the present system, a dividend from CFLCo to BRINCO would be tax free to BRINCO. Dividends paid by BRINCO would be tax free to other Canadian corporations and taxable to its resident Canadian individual shareholders with a 20% tax credit.

White Paper Proposals

Under the White Paper proposals, CFLCo would be a "closely held Canadian corporation" and BRINCO would be a "widely held Canadian corporation". CFLCo would pay the federal and provincial corporation income taxes in the same manner as other Canadian resident corporations. The present provisions for reducing the tax rate on public utility income would be removed.

It is proposed to amend the Public Utilities Income Tax Transfer Act so that the Federal Government would transfer to the Province of Newfoundland 100% of the federal tax collected. Under the agreement between CFLCo and the Province of Newfoundland, CFLCo would receive a rebate of the tax transferred to or collected on behalf of Newfoundland, which is in excess of 22.5% of CFLCo's taxable income. This rebate, as previously explained, would be tax free to CFLCo.

In accordance with the announcement made in the House of Commons on November 28, 1969 by the Minister of Finance, dividends paid by CFLCo to BRINCO would not be taxable to BRINCO to the extent that they were paid out of profits which had borne federal corporation income tax. Dividends paid by BRINCO to its shareholders would carry "creditable tax" only to the extent of one half of the corporation tax actually paid by BRINCO, BRINCO being a "widely held" corporation. Creditable tax would not include any tax paid by CFLCo. Thus BRINCO shareholders are to be denied tax credits which would be available to investors in other types of business.

Two further serious problems arise:

- (a) It is not clear, under the proposed tax system, whether the rebate which would be received tax free by CFLCo would in turn be free of tax to BRINCO. We understand that this is the intention

but the wording in the White Paper does not make clear how this result is to be accomplished. The calculations used in this submission and its schedules assume that funds distributed out of tax rebates would be taxable in BRINCO's hands. Even if distributions of these funds are exempt from tax in BRINCO's hands, they would appear to be taxable when they are, in turn, distributed to BRINCO's shareholders, with the result that the tax is merely shifted to the BRINCO shareholders.

- (b) CFLCo will have very large capital expenditures which will qualify for capital cost allowances. The projections on which the financing of the project was based show that by the year 2000, CFLCo's distributable income will exceed the income upon which it has paid tax by approximately \$100 million as a result of claiming capital cost allowances in excess of depreciation recorded in the accounts. If dividend distributions are made out of income in excess of taxed income, they will be fully taxable in BRINCO's hands even though full tax will eventually be paid on all income of CFLCo as and when book depreciation equals capital cost allowances. The effect of this point is illustrated in Schedules 1 and 2 where it will be seen that, under the White Paper proposals, CFLCo's distributable income will be \$775 from each \$1,000 of operating income whether it is

paying current tax or deferring tax by claiming capital cost allowance in excess of accounting depreciation. These two cases, however, result in quite different tax treatment in BRINCO.

If CFLCo is paying current taxes the only additional tax BRINCO pays is due to the tax free nature of the tax rebate from Newfoundland which has already been discussed. If CFLCo defers its tax payments, then BRINCO pays tax at the full rate on its dividends from CFLCo. The result is that BRINCO can only distribute \$387.5 for each \$1,000 of CFLCo income rather than the \$637.5 it could distribute if CFLCo were paying current tax. Both these figures should be compared with the \$727.5 that BRINCO could distribute under present tax rules. Thus the White Paper proposals will result in extra tax being paid in BRINCO, in these earlier years, which is greater than the tax CFLCo has deferred, despite the fact that the tax deferred by CFLCo will eventually be paid. It follows, therefore, that the tax impact under the proposals is so great that the Company will have two choices: either to claim capital cost allowance at reduced rates in order to pay tax, and hence have sufficient creditable tax to match dividends, or completely refrain from paying dividends until it is required to pay taxes and then limit its dividend payments to taxed income. Few companies can afford the former solution because a new development

requires maximum cash flow to meet debt and other commitments in its early years. The likely result will be to stop the payment of dividends to shareholders for some years, which will in no way increase government tax revenues.

In many enterprises, this may not be a very significant factor, but it will have a very great effect on public utility projects where the capital costs are enormous and the lead time between initial expenditure of money and the payment of dividends can easily exceed 10 years. In the case of Churchill Falls, the first money was spent in 1956 on engineering studies. The first sale of power will be made in 1972 and the project will not be complete until 1976. It is not expected that dividends can be paid before 1977, a period of 21 years since the first investment. The effect of the proposals could be to delay payment of dividends for many more years.

So far as new projects are concerned, the proposals as they affect the interrelation of dividends and capital cost allowance will, quite apart from the other provisions of the White Paper, greatly increase the difficulty in raising equity capital for a development requiring large capital expenditures.

Reduction in after tax income of a shareholder

The reduction in the after tax dividend income of a BRINCO shareholder, which will result from the proposals, depends upon the amount of capital cost allowances claimed by CFLCo and the class of shareholder receiving the dividend.

Schedules 1 and 2 show the detailed calculation for various situations and may be summarized as follows.

	Reduction in after tax income	
	Deferred Tax	Current Tax
A resident shareholder of BRINCO who is:		
a closely held corporation	60%	51%
a widely held corporation	47%	35%
an individual with a 20% marginal rate	36%	22%
an individual with a 40% marginal rate	40%	27%
A non-resident shareholder of BRINCO who holds his interest:		
through a closely held Canadian corporation	60%	51%
through a widely held Canadian corporation	47%	35%
directly	47%	12%

These decreases result from:

- (a) taxes being paid by BRINCO on dividends from CFLCo out of profits on which CFLCo has not paid tax because it claimed capital cost allowances in excess of depreciation provided in the accounts,
- (b) tax rebates received by CFLCo from Newfoundland being taxed in BRINCO or in the hands of BRINCO's shareholders,
- (c) no tax credits being passed on to BRINCO shareholders in respect of taxes paid by CFLCo, and
- (d) the fact that BRINCO as a "widely held" corporation can pass on credit for only one-half of the taxes it does pay.

It is evident that the shareholders of BRINCO, whatever their marginal rate of tax, are being subjected to a very substantial increase in taxes from those applicable at the time the project was financed and the effect of the White Paper proposals is to eliminate completely the effectiveness of the tax arrangements on which the low rates for power and the successful financing of the project were based.

The non-resident who holds his investment through a "closely held" Canadian holding company, or through a corporate chain which includes a "closely held" company, will be subjected to an additional tax of 25% on a dividend paid out of income on which the full corporate tax has been paid by BRINCO. In addition, a 50% tax will be imposed on dividends from BRINCO paid out of dividends received from CFLCo which have been fully taxed in CFLCo but which carry no tax credits. When the non-resident withholding tax is taken into account, the total effective rate of Canadian tax on the underlying profits becomes 70-75%. This is illustrated in Schedule 3.

Effects of the White Paper proposals upon BRINCO and its shareholders in relation to income to be derived from future hydro-electric power developments.

Brinco is currently making a feasibility study of a major hydro-electric development at Gull Island on the Lower Churchill River and has already spent approximately \$2 million

on site investigations and conceptual design work. The project is estimated to cost approximately \$500 million and to have a potential capacity of 2 million horsepower. It would take 4 to 5 years to build and would produce no income prior to 1976 or 1977. The project, if it proceeds, would provide continuing employment for those engaged in construction of the Churchill Falls plant.

Preliminary calculations show that the rate for power will need to be considerably higher than that applicable before the White Paper proposals to provide the necessary debt service and equity return.

The White Paper proposals would seem to make the building of the project impossible as either the power price would not be competitive or the return on investment would be so low as to make it impossible to attract the necessary equity capital and to provide the necessary interest cover on the funded debt.

Suggested Solutions

It is difficult at this time to propose solutions to the problems because any solutions must take into account their effect on all aspects of the proposed tax system.

The modification to the White Paper announced by the

Minister of Finance on November 28th concerning dividends passing from a utility to its parent company was a welcome indication of the Government's desire to overcome one problem but unfortunately this did not by any means solve that particular problem. There still remains the proposal that no tax credits will be available to shareholders of utility companies. It is difficult to see why a utility which in fact pays full federal taxes should be treated differently from any other Canadian corporation. The fact that certain tax payments are earmarked as a grant to a particular province appears to be irrelevant and any suggestion that the problem should be left to be resolved as between CFLCo and the Province of Newfoundland involves CFLCo in a purely federal-provincial fiscal matter in which it has no place. When the overall plan for developing Churchill Falls was arranged among Newfoundland, Hydro-Quebec and CFLCo, with the cooperation of the Federal Government, part of the plan involved the retention by Newfoundland of only 22.5% of CFLCo's taxable income during the term of the power contract, at least 40 years. The suggestion (White Paper 4.65) that the provinces determine to what extent the rebates "..... should be turned over to the corporation or its shareholders" seems unrealistic where the disposition of the rebates has already been agreed upon and reflected in the price of power.

Even if credits for the full taxes paid are allowed to the shareholders the very substantial problem would still

remain with respect to the rebates from Newfoundland to CFLCo. These payments which are technically untaxed income should realistically be treated as though they are taxed income. To achieve this, CFLCo has to be able to pass on creditable tax equal to the full amount of the rebate. Any reduction in transfer payments to the Province to cover creditable tax which reduces the transfer payment below the 95% on which the 40 year power price to Hydro-Quebec was based, will not solve this problem because the agreements between CFLCo and Newfoundland would result in a reduction in the amount of rebate received by CFLCo. The solution to this latter problem as well as the tax credit problem is essential to the fair treatment of BRINCO's shareholders.

The further effect on the after tax income of a shareholder in BRINCO which arises because of the payment by CFLCo of dividends which have not borne full tax because of capital cost allowances is difficult to deal with because most possible solutions seem to produce difficulties in other areas of the system. The impact on a non-resident shareholder would be eliminated if his interest were directly held. The impact on Canadian resident corporate shareholders would be eliminated if the present intercorporate dividend exemption were continued into the new system.

Conclusions

- (a) Because CFLCo is a utility, the proposals will have a substantial impact on the return which shareholders of BRINCO, both resident and non-resident, will receive

and will place investors in utility companies at a severe disadvantage when compared with investors in other industries. Shareholders of BRINCO will, therefore, be severely and unfairly penalized for having invested in a utility project.

- (b) If the proposals are implemented, it is extremely unlikely that any new investor owned utility project will be undertaken and all such projects will have to be financed by government moneys.
- (c) BRINCO has been instrumental in bringing nearly \$700 million of foreign investment into Canada over the last decade. If the White Paper proposals are implemented, the chances of repeating this performance over the next decade are very low.

SCHEDULE 1

EFFECT ON CANADIAN RESIDENT SHAREHOLDER OF BRINCO

Comparison of the treatment of \$1,000 of CFLCo operating income distributed through a corporate chain to the ultimate shareholders under the present and proposed tax systems

		Present System		Proposed System	
		Deferred tax	Current tax	Deferred tax	Current tax
		\$	\$	\$	\$
<div>CFLCo</div> <div>↓</div> <div>Brinco</div> <div>↓</div> <div>To a Canadian resident who is:</div>	Operating profit	1,000.00	1,000.00	1,000.00	1,000.00
	Tax payable: (Note 1)				
	Deferred	272.50	-	225.00	-
	Current	-	272.50	-	225.00
	Available for dividend	727.50	727.50	775.00	775.00
<div>a closely held corporation</div>	Tax paid	-	-	387.50	137.50
	Available for dividend	727.50	727.50	387.50	637.50
<div>a widely held corporation</div>	Tax paid	-	-	96.88	284.37
	Net after tax income	727.50	727.50	290.62	353.13
	Percentage reduction			60%	51%
<div>an individual with a marginal rate of:</div>	Tax paid	-	-	-	166.67
	Net after tax income	727.50	727.50	387.50	470.83
	Percentage reduction			47%	35%
<div>20%</div>	Tax paid (refunded)	-	-	(77.50)	72.50
	Net after tax income	727.50	727.50	465.00	565.00
	Percentage reduction			36%	22%
<div>40%</div>	Tax paid	145.50	145.50	38.75	213.75
	Net after tax income	582.00	582.00	348.75	423.75
	Percentage reduction			40%	27%

Note 1: CFLCo's effective tax rate is at present 27.25% due to the refund of only 95% of Federal tax.

SCHEDULE 2

EFFECT ON NON-RESIDENT SHAREHOLDER OF BRINCO

Comparison of the treatment of \$1,000 of CFLCo operating income distributed through a corporate chain to the ultimate shareholders under the present and proposed tax systems

	Present System		Proposed System	
	Deferred tax	Current tax	Deferred tax	Current tax
	\$	\$	\$	\$
Operating profit	1,000.00	1,000.00	1,000.00	1,000.00
Tax payable: (Note 2)				
Deferred	272.50	-	225.00	-
Current	-	272.50	-	225.00
Available for dividend	<u>727.50</u>	<u>727.50</u>	<u>775.00</u>	<u>775.00</u>
Tax paid	-	-	387.50	137.50
Available for dividend	<u><u>727.50</u></u>	<u><u>727.50</u></u>	<u><u>387.50</u></u>	<u><u>637.50</u></u>
To a non-resident who holds his investment:				
Through a closely held corporation				
Tax paid (Note 1)	109.13	109.13	140.47	337.34
Net after tax income	<u>618.37</u>	<u>618.37</u>	<u>247.03</u>	<u>300.16</u>
Percentage reduction			<u>60%</u>	<u>51%</u>
Through a widely held corporation				
Tax paid (Note 1)	109.13	109.13	58.13	237.29
Net after tax income	<u>618.37</u>	<u>618.37</u>	<u>329.37</u>	<u>400.21</u>
Percentage reduction			<u>47%</u>	<u>85%</u>
Directly				
Tax paid (Note 1)	109.13	109.13	58.13	95.63
Net after tax income	<u>618.37</u>	<u>618.37</u>	<u>329.37</u>	<u>541.87</u>
Percentage reduction			<u>47%</u>	<u>12%</u>

Note 1: Includes non-resident withholding tax at 15% of dividend paid.

Note 2: CFLCo's effective tax rate is at present 27.25% due to the refund of only 95% of Federal tax.

SCHEDULE 3

EFFECT ON R.T.Z. IN RESPECT OF CFLCO

Comparison of the treatment of \$1,000 of CFLCo operating income distributed through a corporate chain to the ultimate shareholders under the present and proposed tax systems

	Present System		Proposed System	
	Deferred tax	Current tax	Deferred tax	Current tax
	\$	\$	\$	\$
Operating profit	1,000.00	1,000.00	1,000.00	1,000.00
Tax payable: (Note 1)				
Deferred	272.50	-	225.00	-
Current	-	272.50	-	225.00
Available for dividend	727.50	727.50	775.00	775.00
Tax paid	-	-	387.50	137.50
Available for dividend	727.50	727.50	387.50	637.50
Tax paid	-	-	96.88	284.37
Available for dividend	727.50	727.50	290.62	353.13
Tax paid	-	-	-	-
Available for dividend	727.50	727.50	290.62	353.13
15% non-resident withholding tax	109.13	109.13	43.59	52.97
Received by RTZ	618.37	618.37	247.03	300.16
Effective rate of Canadian tax	38%	38%	75%	70%

Note 1: CFLCo's effective tax rate is at present 27.25% due to the refund of only 95% of Federal tax.

APPENDIX "D"

NAME: BRITISH NEWFOUNDLAND CORPORATION LIMITED

SUBJECT: Effect of White Paper proposals on
resident and non-resident investors
in companies engaged in development
of natural resources.

Analysis of Appendix "C" by Senior Advisor

This Brief is submitted by British Newfoundland Corporation Limited - a widely held Canadian resident corporation. About 20,000 Canadian resident shareholders hold 40% of the issued shares, non-resident shareholders hold directly 11% of the issued shares, and the remaining 49% are held by Thornwood Investments Limited, a closely held Canadian resident shareholder. Thornwood Investments Limited is controlled by Rio Tinto-Zinc Corporation and Bethlehem Steel Corporation is a minority shareholder.

British Newfoundland Corporation Limited is engaged in the development of natural resources of Newfoundland and Labrador through three subsidiary companies:

- (1) Churchill Falls (Labrador) Corporation Limited, developing hydro electric power in Labrador, this company owns 57% of the issued capital, the remaining 43% being owned by the Province of Newfoundland and Hydro Quebec.
- (2) British Newfoundland Exploration Limited, a wholly owned subsidiary. This company operates a copper mine in Newfoundland and is actively exploring for minerals in Labrador and Newfoundland.
- (3) Twin Falls Power Corporation Limited, a power company located in Labrador.

British Newfoundland Corporation Limited also studies potential developments of power sites and to date has been instrumental in arranging for and providing funds for these developments, of an amount of \$1,029 millions.

The Brief deals with the impact of the White Paper proposals on the shareholders of British Newfoundland Corporation Limited in relation to its income derived from Churchill Falls (Labrador) Corporation Limited.

It does not attempt to repeat the submission made by others, regarding the adverse effect of the proposals respecting mining and exploration activities.

The Brief

- (1) On pages 8 and 9 outlines the present tax position of the organization and its shareholders.
- (2) On pages 8 and 9, outlines the tax position of the organization if the White Paper proposals are implemented.
- (3) On pages 9 to 12, deals with the problems of rebate of tax by the province and excess capital cost allowances.
- (4) On pages 12 to 14, deals with the reduction in income that will be received by shareholders.
- (5) On pages 14 and 15, makes the point that proposed future developments may have to be abandoned.
- (6) On pages 15 to 17, states that it is difficult to make reasonable suggestions in view of the time it has taken to develop the organization and the long period of time for which power has been sold in the future.

The Brief concludes with the following observations on pages 17 and 18.

- (1) "Because CFLCo is a utility, the proposals will have a substantial impact on the return which shareholders of BRINCO, both resident and non-resident, will receive and will place investors in utility companies at a severe disadvantage when compared with investors in other industries. Shareholders of BRINCO will, therefore, be severely and unfairly penalized for having invested in a utility project."

- (2) "If the proposals are implemented, it is extremely unlikely that any new investor owned utility project will be undertaken and all such projects will have to be financed by government moneys."
- (3) "British Newfoundland Development Corporation Limited has been instrumental in bringing nearly \$700 million of foreign investment into Canada over the last decade. If the White Paper proposals are implemented, the chances of repeating this performance over the next decade are very low."
- The attention of the Committee is drawn to the following

remarks:

- (1) "As a result, shareholders of utilities will be much more heavily taxed than shareholders of other industries. The shareholders of BRINCO will not only bear substantially higher taxes in respect of utility income but will be denied even the partial relief now provided by the 20% dividend credit. The effect of this is so marked that it is hard to conceive of a utility project in which the public would be prepared to invest if the proposals are put into effect. Shareholders locked into existing utility investments will be heavily penalized by the tax proposals unless utility rates are increased to the customer. In the case of BRINCO this method is not available as power has been sold to Hydro-Quebec for 65 years at agreed prices." (Pages 1 and 2 of the Brief).
- (2) "The investment of money in grass-roots mineral exploration is a high risk type of investment. The investor cannot be sure of any return and he has to expect that any return will be delayed for a number of years. Nevertheless, it is only the willingness of investors to take such risks that has made possible the present position of the Canadian mining industry." (Page 5 of the Brief).

- (3) "The White Paper proposals with respect to taxation of utilities and mining companies, together with the proposed system of tax credits, can only discourage investment in these industries by both residents and non-residents, to the ultimate detriment of Canada."
(Page 6 of the Brief).
- (4) "So far as new projects are concerned, the proposals as they affect the interrelation of dividends and capital cost allowance will, quite apart from the other provisions of the White Paper, greatly increase the difficulty in raising equity capital for a development requiring large capital expenditures."
(Page 12 of the Brief).
- (5) The Brief on pages 14 and 15 comments upon a study presently being made for a major hydro electric development and concludes with:
"The White Paper proposals would seem to make the building of the project impossible as either the power price would not be competitive or the return on investment would be so low as to make it impossible to attract the necessary equity capital and to provide the necessary interest cover on the funded debt."
(Page 15 of the Brief).

There is attached the usual summary of existing income tax laws, White Paper proposals and principal points of the Brief.

APPENDIX "E"

April 1970

SUBMISSION
OF
THE RIO TINTO-ZINC CORPORATION LIMITED

TO
THE STANDING SENATE COMMITTEE

ON
BANKING, TRADE AND COMMERCE

WITH RESPECT TO
THE GOVERNMENT OF CANADA'S
PROPOSALS FOR TAX REFORM

London, England

THE RIO TINTO-ZINC CORPORATION

The Rio Tinto-Zinc Corporation Limited (RTZ) is a United Kingdom company with over 100,000 shareholders of whom 77% are U.K. residents. The largest single shareholder, Charter Consolidated Limited (a U.K. company), holds approximately 9% of the outstanding shares and no other shareholder holds more than 3.5%. (Further information with respect to the shareholdings in RTZ, Rio Algom and Brinco is set out in Schedule I hereto.) The principal centres from which the RTZ Group of companies operate are located in the United Kingdom, Canada, Australia, Africa and the United States. Companies in the Group operate on an autonomous basis with the United Kingdom corporation providing a focal point for the co-ordination of knowledge and skills and a reserve central strength for finance.

RTZ's principal Canadian investments consist of an approximate 51% beneficial interest in Rio Algom Mines Limited ("Rio Algom") and an approximate 43% beneficial interest in British Newfoundland Corporation Limited ("Brinco") which in turn holds approximately 57% of the shares of Churchill Falls (Labrador) Corporation Limited ("CFLCo"). The chart attached as Schedule II describes the shareholdings in principal Canadian companies in which RTZ has an interest.

DEVELOPMENT OF RIO ALGOM

Rio Algom is one of Canada's major mining companies with extensive interests in uranium and is the largest specialty steel producer in the British Commonwealth.

Rio Algom has approximately 17,500 share-holders. Approximately 33% of its shares are held by the Canadian public and approximately 7% by a large number of non-resident shareholders. Preston Mines Limited, a Canadian company, holds approximately 44% of the outstanding shares and the balance is held by Tinto Holdings Canada Limited ("Tinto Holdings"), a wholly-owned subsidiary of RTZ. Tinto Holdings also holds approximately 81% of the shares of Preston Mines Limited, the balance of the shares being held by the general public. RTZ's net beneficial interest in Rio Algom is approximately 51%.

Prior to the formation of Rio Algom, the Blind River uranium deposits in Northern Ontario were being developed by many companies. RTZ had played a major role in arranging the financing of four of these companies both by purchasing equity and debt and by arranging other financing. When one of these companies, Northspan Uranium Mines Limited, experienced

a substantial cost overrun and the completion of its mine was in jeopardy, RTZ arranged the necessary funds for the mine's completion.

In 1959 when it was announced that the U.S. Government would not exercise its option to purchase further uranium, the four companies were faced with a complete shutdown of operations.

In order to give effect to the Government's stretch-out policy under which the production from the various mines could be sold over a greater number of years, the four uranium companies were amalgamated to form Rio Algom Mines Limited. This enabled production under all four contracts to come from one mine which could be kept in production until a demand for uranium for peaceful purposes developed.

In 1963 Rio Algom purchased all of the assets of Atlas Steels Company, a major specialty steel producer. Because of the additional cost of building the new steel production facilities at Tracy, Quebec, substantial additional funds were required to ensure its completion. After the acquisition of the Atlas Steels assets, Rio Algom raised approximately \$50 million by

an issue of bonds. As a result of Rio Algom's financial resources, a substantial new steel producing facility has been brought into operation at Tracy, Quebec.

In addition to its uranium and steel operations, Rio Algom arranged for the financing and bringing into production of the Poirier copper mine in the Province of Quebec and the Anglo-Rouyn mine in Northern Saskatchewan. Rio Algom has also provided management and has arranged very substantial financing for Lornex Mining Corporation Limited ("Lornex") which is developing a copper mine in British Columbia planned to be the largest mine in Canada.

Rio Algom carries out an extensive mineral exploration program in Canada and has expended a total of \$9.6 million since 1965. Expenditures in 1969 amounted to \$2.7 million and higher expenditures are planned in 1970.

DEVELOPMENT OF BRINCO

After Newfoundland joined Confederation in 1949 a major drive was launched to explore the resources of that province. As a result the British Newfoundland Corporation Limited was formed by seven industrial, banking and finance houses (mainly British and including the Rio Tinto Company) to explore and develop certain of the mineral and water power resources of the province.

Brinco was granted exclusive mineral rights for a 20 year period over extensive areas of both Newfoundland and Labrador and also rights to develop river systems in both areas.

Brinco's shares were listed on the Stock Exchanges in Montreal (1965) and Toronto (1967) and there are now some 20,000 Canadian shareholders owning approximately 40% of the shares. Approximately 11% of Brinco's shares are held directly by non-residents and 49% are held by Thornwood Investments Limited in which RTZ has the majority interest and Bethlehem Steel Corporation of the United States has a minority interest.

CFLCo was formed as a subsidiary of Brinco in 1958 to develop the drainage basin of the Upper Churchill River. A subsidiary of CFLCo (Twin Falls Power Corporation Limited) was set up to carry out an initial limited power development in the area. A 120,000 horsepower hydro-electric development was completed in 1962 to supply power needed by iron mines in Western Labrador. The installation now has a capacity of 300,000 horsepower and has cost approximately \$60 million.

By 1964 sufficient work had been done (at a cost of nearly \$10 million) to establish the feasibility of

developing hydro-electric power at Churchill Falls. Negotiations for the sale of power which commenced prior to 1964 resulted in a letter of intent with Hydro-Quebec in 1966. Following this, a further three years of negotiation were required before the final power contract and financial agreements were signed in 1969. The Churchill Falls development will be completed in 1976 and will then have a capacity of 7,000,000 horsepower. It will cost approximately \$950 million of which approximately \$270 million has already been spent. The funds for the project have been obtained from equity investment (\$83 million), bond issues in Canada and the United States (\$690 million) and loans available from Canadian chartered banks (\$150 million).

In 1968 when the major financing for the huge Churchill Falls power development was being arranged Brinco was in a difficult financial position. Brinco had borrowed \$21 million to finance development of Churchill Falls during the period when the power contract and the major financing were being negotiated. Because of the long period of construction it was clear that Brinco could not expect any return from its investment for many years to come and would have to refinance in order to discharge its indebtedness. At the same time the prospective

purchasers of Churchill Falls mortgage bonds were concerned not only that Brinco be in a sound financial position but also that it in turn be supported by a major company whose interest was substantial enough that it would see the power project through to completion. In order to achieve this, RTZ and Bethlehem Steel Corporation acting through Thornwood Investments Limited purchased most of the English and European holdings in Brinco. Thornwood then purchased \$18.8 million worth of treasury shares of Brinco and underwrote a rights offering for a further \$23.5 million. As a result of this financing Brinco was able to discharge its indebtedness and the financing of CFLCo was completed. It was the support of RTZ both in financing and providing management that made the Churchill Falls project possible.

Two further potential power sites (estimated to have a capacity of 3,000,000 horsepower) exist on the lower Churchill River and site investigation and preliminary studies costing \$2 million have been carried out at Gull Island - the larger of the two sites.

Brinco, through a wholly-owned subsidiary, British Newfoundland Exploration Limited ("Brinex"), now holds mineral exploration rights over approximately 49,000 square

miles in Newfoundland and Labrador, as well as oil and gas rights over 7,000 square miles in Newfoundland. Brinex has so far spent some \$11 million on exploration and further expenditures of approximately \$3 million are budgeted for 1970.

Brinex has brought the Whales Back copper mine in Newfoundland into production at a cost of approximately \$7.2 million. It has also completed geological reconnaissance on more than 70,000 square miles and prepared detailed geological mapping on 17,000 square miles in Labrador.

SUMMARY OF RTZ DEVELOPMENTS IN OTHER PARTS OF THE WORLD

Australia

The RTZ industries in Australia are represented by an 83% shareholding in Conzinc Riotinto of Australia Limited (CRA). CRA is one of the largest corporations in Australia and has by far the most extensive range of natural resource interests in that country. CRA is itself international, holding extensive interests overseas and in line with RTZ policy elsewhere in the world, CRA's own larger subsidiary companies also have extensive Australian share participation.

RTZ interests in Australian natural resources through CRA include the world's largest deposit of commercial grade bauxite at Weipa in Queensland; one of the largest copper mines in the world (under construction) at Bougainville in the Solomon Islands; the large iron ore mine at Hamersley, which on the completion of its present expansion will be the largest iron ore mine in the world; the largest lead refinery in the world; extensive lead and zinc mines; coking coal; timber; and a range of other commodities. CRA has a substantial interest in an integrated aluminum industry in Australia and in a new aluminum smelter being constructed in New Zealand. CRA also owns a major interest in the Mary Kathleen uranium mine.

South Africa

The Palabora copper mine, smelter and refinery;
Rossing - by far the largest uranium deposit
so far discovered in the world;
Various other mining interests.

United States

The U.S. Borax deposits in the Mojave Desert,
the world's largest borax mine;
The Humecca uranium deposit in Utah.

Other

The Group has developed many more resources and is engaged in smelting and many other industrial activities relating to natural resources. The Group carries on continual exploration activity throughout the world. The world-wide operations of the RTZ Group are described in the enclosed booklet entitled "RTZ Explained".

MANAGEMENT AND PARTICIPATION IN RTZ ENTERPRISES

The management of RTZ is decentralized with control of operations in the hands of autonomous subsidiary companies in the countries where they operate. The London organization plays a key role in providing finance for major projects and ensuring that adequate staffing and management exists in the subsidiary companies. This is done where possible by recruitment in the country concerned but if this is not feasible, the Group has experienced mobile people who are made available through long-term secondment.

It is also the Group's policy and practice once a project has passed its initial stages to invite a large measure of equity participation by residents of the country in which the operation is situated. Along with this equity participation goes a policy of appointing as directors of the various national companies a high proportion of persons who are nationals.

To assist in understanding this submission, the structure of the RTZ Canadian group of companies is set out in Schedule II. Basically, the structure consists of a resident wholly-owned holding company which owns the RTZ part of the two main operating companies, Rio Algom and British Newfoundland Corporation Limited. The RTZ holding company's beneficial interest in these companies is approximately 51% in Rio Algom and 43% in Brinco.

SUMMARY OF THIS BRIEF

The far-reaching proposals in the White Paper inevitably have many long term effects on a group as diverse and complex as RTZ. To reduce this brief to a manageable size, few comments are made on matters which affect companies in general and which it is expected will be covered fully in submissions by others. Further, some matters of crucial significance to RTZ's future activities in Canada are only briefly mentioned as this material is covered fully in separate briefs submitted by Brinco and Rio Algom.

The most severe burdens on RTZ's activities in Canada are caused by the integration proposals. It is submitted that any acceptable integration proposal should be neutral in so far as group structures are concerned.

In other words, the ultimate shareholders should be left in exactly the same position as if they had invested directly in the individual operating companies in the group. The proposals in the White Paper, however, impose heavy penalties on non-resident shareholders who have encouraged substantial domestic share participation in their operating companies and adopted corporate structures suited to this participation. It should be emphasized that these penalties would not be suffered under the proposals if the non-resident were to hold his interest directly in the operating companies, a situation which would be relatively easy to achieve if domestic participation in the enterprise had not been encouraged.

In essence the penalties referred to above arise for the following reasons:

- (a) The income of an operating company might not, in accordance with various proposals in the White Paper, carry creditable tax when paid to a shareholder. Examples of this are utility income and income from foreign subsidiaries in treaty countries. This income is, however, subjected to tax when it is eventually passed on to the operating company's resident shareholders.

- (b) Due to the differing degrees to which integration is applied to widely-held and closely-held corporations, additional tax always arises when a dividend is paid from the former to the latter even if it is paid out of profits that have been fully taxed. This proposal is particularly severe when a U.K. group such as RTZ has structured its Canadian interests to accommodate Canadian participation.

The brief deals with the impact of the White Paper in the following areas:

- On operating companies
- On shareholders
- On income from foreign sources
- On corporate structures

EFFECT OF WHITE PAPER PROPOSALS ON OPERATING COMPANIES

(a) CFLCo and Brinco

CFLCo is a utility company and is particularly affected by paragraphs 4.63, 4.64 and 4.65 of the White Paper and amendment related to utilities announced by the Minister of Finance in the House of Commons on 28 November 1969.

Existing tax system

The present tax position of CFLCo as a public utility is as follows:

CFLCo will pay both federal and provincial income taxes, at the full rate applicable to public utility income. Under the Public Utilities Income Tax Transfer Act, the federal government transfers to the Province of Newfoundland 95% of the federal tax collected (with the exception of the 3% Old Age Security Tax). In addition, all the provincial tax collected on Newfoundland's behalf is transferred to the province. The Province of Newfoundland has agreed to rebate to CFLCo the amount of taxes received by it in excess of 22.5% of CFLCo's taxable income. Such rebate would be tax free to CFLCo under the provisions of the Public Utilities Income Tax Transfer Act.

This rebate has been fully taken into account in arriving at the reduced prices to be paid for power by Hydro-Quebec. If it had not been arranged that Newfoundland would refund part of the income taxes paid by CFLCo, CFLCo would have had to raise its price for power in order to provide the same rate of return to CFLCo.

Dividends paid by CFLCo to Brinco are tax free to Brinco. Dividends paid by Brinco are tax free to other Canadian corporations and taxable to its Canadian individual shareholders with a 20% tax credit.

White Paper Proposals

Under the White Paper proposals, CFLCo would be a "closely-held Canadian corporation" and Brinco would be a "widely-held Canadian corporation". CFLCo would pay the federal and provincial corporation income taxes in the same manner as other Canadian resident corporations. The present provisions for reducing the tax rate on public utility income would be removed.

It is proposed to amend the Public Utilities Income Tax Transfer Act so that the Federal Government would transfer to the Province of Newfoundland 100% of the federal tax collected. Under the agreement between CFLCo and the Province of Newfoundland, CFLCo would receive a rebate of the tax transferred to or collected on behalf of Newfoundland which is in excess of 22.5% of CFLCo's taxable income. This rebate would be tax free to CFLCo.

The normal rules for inter-company dividends provide that the receiving corporation would pay tax on the dividend received grossed-up by the paying corporation's creditable tax, and would retain credit for the creditable tax. The gross tax paid by the receiving

corporation would be the basis for its own creditable tax.

However, dividends paid by a utility company would be treated differently. In accordance with the announcement made in the House of Commons on November 28, 1969, by the Minister of Finance, if dividends were paid by CFLCo to Brinco out of profits that have borne Federal Corporation Income tax, neither tax nor tax credit would arise in Brinco in respect of such taxes. Accordingly, there would be no mechanism by which CFLCo's taxes could flow through Brinco and be available for credit to Brinco's shareholders. Thus, Brinco's shareholders would be denied tax credits that would be available to investors in other types of business.

Two further serious problems arise:

- (i) It is not clear, under the proposed tax system, whether tax rebates from Newfoundland which would be received tax free by CFLCo, would in turn be free of tax to Brinco. We understand that this is the intention but the wording in the White Paper does not make clear how this result is to be accomplished. The calculations used in this submission and its schedules assume that funds distributed out of tax rebates would be taxable in Brinco's

hands. Even if distributions of these funds are exempt from tax in Brinco's hands they would appear to be taxable when they are, in turn, distributed to Brinco shareholders, with the result that the tax is merely shifted to the Brinco shareholders.

- (ii) CFLCo will have very large capital expenditures qualifying for capital cost allowances. The projections on which the financing of the project was based show that by the year 2000, CFLCo's distributable income will exceed the income upon which it has paid tax by approximately \$100 million as a result of claiming capital cost allowances in excess of depreciation recorded in the accounts. If dividend distributions are made under these circumstances, they will be fully taxable in Brinco's hands even though full tax will eventually be paid on all income of CFLCo as and when book depreciation equals capital cost allowances. The extra taxes which would result in such circumstances will mean that CFLCo will delay paying dividends until they can be paid out of taxed income. As such, the real effect of the White Paper

proposals, in this regard, is not that they will raise additional tax but that they will unduly restrict the cash flow to be received by Brinco from CFLCo and thus restrict the dividends paid to Brinco's shareholders.

As can be seen on Schedules III and IV (which show the position of resident and non-resident shareholders) the after tax dividend income of a Brinco shareholder decreases from 12% to 60% depending upon the amount of capital cost allowances claimed by CFLCo and the class of shareholder receiving the dividend. The effect of the proposals on Brinco and its shareholders under the White Paper is dealt with fully in a separate brief submitted to the Committee by Brinco.

(b) Rio Algom and Lornex

The effect of the proposals on the return from investments in mining ventures will invariably be adverse but the extent of this adverse effect depends on the individual circumstances of each mining venture including the size and grade of the ore bodies developed and the expected life of the mine. Lornex, for example, which is managed and part owned by Rio Algom is developing a large, low-grade deposit requiring considerable investment and expected to have a long life.

Calculations for this mine, assuming that the White Paper proposals are in full force throughout its life, show that the total federal tax payments by Lornex increase by 62% and that the present value of the net cash flow from the mine, assuming a discount rate of 10%, decreases by 21% compared to operating under the present tax system. In these calculations copper prices well below current levels have been used to ensure that there was no possibility of the adverse effect being overstated.

The present value of the cash flow of the Lornex mine under the present and proposed Canadian tax systems can be compared with the value of the discounted cash flow of an assumed identical mine in Australia, in South Africa and in the United States, countries notable for their mining opportunities. The table in Schedule V makes this comparison with respect to return to the operating company and also to a holding company in each country. It is significant that whereas Canada's present system allows a somewhat greater return from a mining venture than the systems in the other countries, the proposals would reduce the return in Canada to a level considerably below that of the other countries.

The combined load of federal and provincial taxes under the proposals is not consistent with maintaining the incentives to which the White Paper refers. Indeed, since substantial provincial mining taxes and royalties are already imposed, the federal proposals will result in the mining industry being more heavily taxed than other industries.

The effect of the proposals on mining and exploration companies under the White Paper is dealt with in more detail in a separate brief submitted to the Committee by Rio Algom.

EFFECT OF WHITE PAPER PROPOSALS ON SHAREHOLDERS

(a) Dividend distributions

The effect of the White Paper proposals on the existing RTZ Canadian corporate organization is to impose very substantial additional taxes on distributions to shareholders. This result occurs whenever dividends are paid which for one reason or another do not carry creditable tax and whenever dividends, even though carrying creditable tax are paid by a widely-held corporation to a closely-held corporation.

In the case of RTZ's Canadian investments, dividends carrying no creditable tax will result from at least four causes:

- (i) the special tax treatment of public utilities;
- (ii) foreign income from controlled subsidiaries in treaty countries;
- (iii) depletion allowances claimed by mining subsidiaries and
- (iv) capital cost allowances claimed in excess of accounting depreciation.

Under the existing corporate structure, dividends from operating companies in the RTZ group pass through one or more widely-held corporations and eventually to a closely-held Canadian corporation wholly owned by RTZ. Under the proposals, where such distributions are received by widely-held corporations, they would be taxed at the rate of 33-1/3% to the extent that they do not carry creditable tax. When they are further passed on to a closely-held corporation, the effective rate of tax would be increased to 50%. The effect of the proposals is to nullify in the hands of the investor the tax treatment accorded to the underlying operation and to penalize the form of corporate structure often adopted by non-resident investors.

A further effect on inter-corporate distributions under the proposals is that a closely-held corporation pays additional tax of 25% of dividends received from a widely-held corporation even though the widely-held corporation is

fully taxed and such tax is creditable. When the non-resident withholding tax is also taken into account, the total effective rate of Canadian tax on the underlying operating profits can become in excess of 70%. These effects are illustrated in Schedules VI and VII.

An example of the magnitude of the effect of the proposals is that the after tax cash flow to RTZ's Canadian holding company from Lornex (discounted at 10% and assuming a 46¢ copper price) would be reduced by 47%. If Lornex were taxed under the rules applicable in other countries this after tax return would be 60% greater in the U.S.A., 64% greater in South Africa and 72% greater in Australia compared to the return under the White Paper proposals. (See Schedule V).

The effect of the proposals on an investment in a public utility subsidiary is to reduce the cash flow to a corporate investor by up to as much as 60%. (See Schedules III and IV).

As explained in more detail below, these problems would have little effect on RTZ if there were not substantial Canadian public participation in the equity of each company.

(b) 5 year revaluation

Because there is substantial Canadian participation in RTZ's Canadian undertakings, RTZ's shareholdings in

Canada are in widely-held corporations and as such would be subject to the five year revaluation proposal. The five year revaluation proposal would not apply if RTZ followed a policy of operating through wholly-owned Canadian subsidiaries.

The five year revaluation proposal raises a number of problems, many of which have been dealt with by others. We would, however, like to point out that to the extent that earnings are retained by subsidiary companies they would tend to be reflected in the five year revaluations and be effectively taxed under this provision. As a result the adverse effects of the integration proposals resulting from taxation at the shareholder level of earnings not taxed in the corporation could not be avoided by simply refraining from making distributions (see heading Dividend distributions above). We would also point out that the quoted market value for shares of a widely-held subsidiary engaged in developing natural resources could substantially exceed the real value to the holding company based on anticipated cash flow with the result that the holding company would be taxed on a notional gain which it has no hope of realizing through return on its investment. If the corporation

were to sell shares from a large block, it is most unlikely that it could realize the market value.

Although the tax burden on the holding company is extremely heavy, it would appear even heavier to the non-resident investor since capital gains tax imposed on a revaluation basis would not be creditable in any foreign country against the capital gains tax imposed in the foreign country since foreign countries do not in these circumstances impose tax upon unrealized capital gains.

In any event it is hoped that if taxation of capital gains is imposed in Canada, Canada will negotiate treaties to avoid double taxation in this area.

(c) Corporate Reorganizations and Intergroup Transfers of Assets

RTZ is extremely concerned about the restrictive effect of the White Paper proposals that capital gains tax should apply to transactions within a Canadian group of affiliated companies.

The proposal in the White Paper that reorganizations involving only the shares of "widely-held" Canadian corporations be non-taxable is welcome but does not go far enough.

Unless adequate provisions of this nature are made, the capital gains tax may very severely inhibit the natural growth and development of a group of companies.

(d) "Staledating" of tax credits in widely-held corporations

The reasons for requiring that creditable tax be distributed to shareholders within $2\frac{1}{2}$ years seem to apply only to closely-held corporations, and we think that the application of this proposal to widely-held corporations should be reconsidered. In many cases the needs of resident shareholders and non-resident shareholders may conflict. A non-resident direct investor is unlikely to be affected by staledating since his tax credit position is determined by the foreign law. At the same time the non-resident may be taxable on stock dividends. (The position of a U.K. investor is not entirely clear and may vary due to the circumstances.)

RTZ has been anxious to arrange its affairs so that possible conflicts of interest with Canadian shareholders are minimized. A possible future cause of conflict would be avoided if the staledating provisions were not applied to widely-held corporations.

EFFECT OF WHITE PAPER PROPOSALS ON INCOME FROM FOREIGN SOURCES

The Atlas Steel division of Rio Algom carries on business in most parts of the free world and has nine subsidiaries in various countries, including two U.S. subsidiaries. Tinto Holdings itself has a South African subsidiary which holds an interest in the large Palabora mine.

We welcome the suggestions for flow-through of foreign withholding taxes (White Paper 6.27) as removing an impediment to Canadian companies with foreign shareholders becoming substantial international corporations. However, the effect of the integration proposals as set out above unfortunately imposes a greater impediment to this desirable objective.

Under the White Paper proposals set out in paragraph 6.15 a company such as Rio Algom could receive dividends from its foreign operating subsidiaries in treaty countries free of Canadian tax. Further, foreign withholding tax on such dividends up to a maximum of 15 percentage points could flow through for eventual credit in the hands of Rio Algom's shareholders. Unfortunately, however, dividends paid

by Rio Algom out of foreign dividends which had borne no Canadian tax would not carry any creditable tax and would be fully taxable in the hands of shareholders such as Tinto Holdings except for the possible flow-through of 15 percentage points of foreign withholding tax.

EFFECT OF WHITE PAPER PROPOSALS ON CORPORATE STRUCTURE

(a) Existing structure

The heaviest impact of the proposals on the RTZ organization will arise because of the corporate structure of the RTZ group under which dividends pass through several widely-held and closely-held corporations before earnings are finally distributed to the United Kingdom company. This corporate structure is necessary because of the substantial public participation in RTZ's Canadian companies and has no adverse tax effect under the present Canadian tax provisions where dividends between taxable Canadian corporations are tax free.

The main reasons for the form of existing corporate structure are:

(i) Dividend Policy

The most important reason for using the existing form of organization is to ensure that the dividend policy of the operating company can meet the requirements of the minority shareholders without conflicting with the requirements of the parent company.

(ii) United Kingdom foreign exchange control

Under United Kingdom foreign exchange regulations, dividends received by a United Kingdom company are required to be converted to Sterling. The funds received can then be reinvested outside the Sterling area only with permission of the Bank of England, which is usually difficult to obtain and if obtained would normally involve the payment of a substantial investment dollar premium. By using a Canadian holding company RTZ's share of any dividends paid by

an operating company remain available for use in Canada without being automatically subject to the restrictions imposed on U.K. funds.

(iii) United Kingdom taxes

The holding company arrangement also enables Canadian source earnings to be accumulated in Canada without reduction by United Kingdom tax.

(iv) Desire for Canadian participation

A holding company is only required where the Canadian public has a substantial participation. RTZ's holding companies have resulted from its policy of encouraging substantial domestic share participation.

(b) Possible reorganization

If it were possible to restructure RTZ's Canadian corporations, the objective of any new structure would be to enable RTZ's present Canadian holding company to receive its share of profits from any underlying investment

directly and not by way of dividend. If the profit is to be received by way of dividend RTZ would ensure that every dividend-paying corporation in the chain was a closely-held corporation which exercised a partnership option. For example, if RTZ wishes to develop a mining prospect with Canadian public participation it would insist that the Canadian public's interest in the operating company be held through a widely-held holding company. RTZ would then hold its interest in the operating company directly or through another closely-held corporation so that the partnership option could be exercised. This pattern could be repeated several times and a typical chain of corporations is illustrated by Schedule VIII.

If this is the desirable corporate organization for the future, it follows that existing corporate structures should if possible be reorganized so that they conform to the same pattern. The impact of the proposals is so great that such reorganizations would have to be considered despite the expense and many other difficulties involved. Such a reorganization would involve the existing widely-held corporation transferring its assets

to a new corporation. The non-resident holding company would then exchange its interest in the existing widely-held corporation for a direct interest in the new corporation. As a result, the new corporation would have only two shareholders, the widely-held corporation whose shareholders would be the public and the non-resident holding corporation (or a closely-held subsidiary of the non-resident holding corporation).

Some of the problems which would result are as follows:

- (i) It is by no means certain under present laws that existing corporate structures can be reorganized into the desired pattern. If they cannot be so reorganized, they will be severely prejudiced in comparison to new structures and in comparison to foreign investment in corporate structures which do not suffer the increased tax or which can be reorganized.
- (ii) Amending existing corporate structures will probably involve not only the sale of assets by existing widely-held corporations but the liquidation of existing

widely-held corporations. Such liquidations could result in heavy tax penalties to Canadian individual shareholders.

- (iii) The Canadian shareholder will not have a direct interest in the operating company. Because the shareholder in the operating company through which the public has its interest is another Canadian company, only the holding company is entitled to general shareholders' information and compliance with security laws. Thus the individual shareholder's right to require operating management to account to him for the business is removed.
- (iv) The non-resident must never lose control of the closely-held operating company for, if he does, he might lose the opportunity to have it treated as a closely-held corporation.
- (v) The necessary transfers of assets would involve very substantial expense consisting not only of the actual costs of transfer of assets, shareholders' meetings, etc., but also of increased interest rates where bondholders' or debentureholders' consents are required.

(vi) The Canadian shareholder would have an interest in a holding company rather than in an operating company. Traditionally the market would value his shares at something less than the break-up value of the holding company.

While our point of view in this memorandum is that of the non-resident, the several disadvantages for the resident investor mentioned above would be reflected for the non-resident in a higher cost of the domestic Canadian capital which he would seek for Canadian developments. From this, it follows that the number of Canadian projects which the non-resident would find it economical to develop in conjunction with Canadian capital would be reduced in comparison with those under a tax system which did not impose any taxes on inter-corporate dividends.

SUGGESTED SOLUTIONS

At this stage it is difficult for us to propose solutions to the problems we have posed simply because in suggesting solutions one must take into account their effect on all aspects of the proposed tax system.

It must be ensured that the combination of provincial and federal taxes on mines be at a level consistent with creating the incentives to which the White Paper refers. If this cannot be achieved through the medium of federal-provincial discussions, we believe that a tax credit rather

than a deduction should be given in the federal system for provincial mining taxes. It also seems reasonable that shareholders should receive creditable tax for the full amount of all federal and provincial taxes.

In the area of determining the taxable income of mining companies, it may be suggested that the extra deduction for exploration expenses and new mine facilities be increased by a factor greater than the proposed one-third and be deductible up to the full extent of income. It may also be suggested that the expenses qualifying for such extra deduction be broadened to include expenditures on existing facilities as would occur in the typical development of an oilfield. This would improve the incentive for exploration and development which the government is evidently seeking.

For inter-corporate distributions, we have considered a number of suggestions, many of which seem to produce difficult problems in other areas of the system. One possibility is to retain the system of exempting inter-corporate dividends from tax. It is recognized that this would leave open some of the problems which exist under the present system and would necessitate retaining the concept of a Personal Corporation.

CONCLUSIONS

- (a) The proposals impose a heavy and inequitable tax penalty on foreign investors who have for good reasons chosen corporate structures under which investments in widely-held corporations are held through Canadian holding companies.
- (b) The penalty of such corporate structures is greatly magnified if the operating company distributes dividends which do not carry creditable tax.
- (c) It is unlikely that reorganizations of existing corporate structures to overcome such penalties can take place. Even when they can, they will experience many difficulties and have serious adverse effects on both resident and non-resident investors.
- (d) The corporate structures dictated by the proposals appear inappropriate for both the resident and non-resident investor.
- (e) The proposals have a noticeable impact on the rates of return now available from mining ventures in Canada, and the combination of provincial and federal taxes leave little if any incentive effect.

- (f) Some reduction in combined federal and provincial taxation of Canadian mining operations is necessary if any incentive effects are to be retained.
- (g) The proposals for inter-corporate dividends should be amended to ensure that non-resident investors are fairly treated.
- (h) Equity dictates that the proposals with respect to public utilities be amended to overcome the severe penalties imposed on investment on those companies. (This is more fully dealt with in the Brinco brief.)
- (i) Tax on capital gains should be imposed only upon realization.

SCHEDULE I

Geographical distribution of shares of
The Rio Tinto-Zinc Corporation Limited
and its controlled Canadian companies

(1) The Rio Tinto-Zinc Corporation Limited

<u>Held in:</u>	<u>Percentage of total shares</u>
United Kingdom	77
Continental Europe	10
North America	4
Australia	5
Bearer shares (mainly Continental Europe)	4

Total number of shareholders - 98,541

The largest single shareholder is Charter Consolidated Limited
(a U.K. company and member of the Anglo-American Corporation Group)
which holds approximately 9% of the issued shares.

(2) Controlled Canadian companies

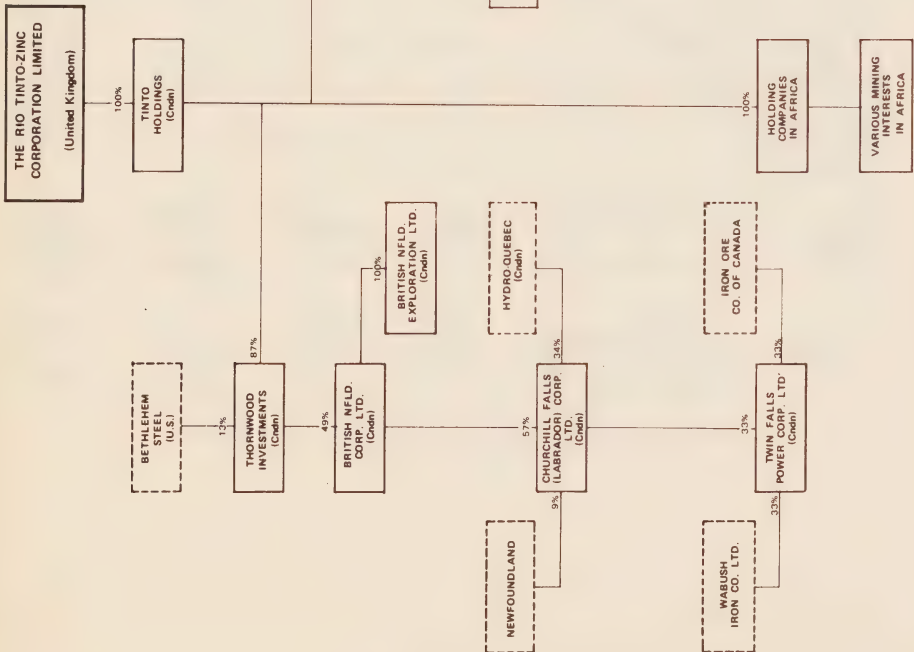
	<u>Rio Algom Mines Limited</u>		<u>British Newfoundland Corporation Limited</u>	
<u>Shares held by public in:</u>	<u>Number of shareholders</u>	<u>Percentage of total shares</u>	<u>Number of shareholders</u>	<u>Percentage of total shares</u>
Canada	10,223	33.1	20,602	40.5
United Kingdom	98	0.4	82	2.5
United States	6,867	6.1	1,259	4.1
Other	268	0.4	116	4.2
Total public holdings	<u>17,456</u>	40.0	<u>22,059</u>	51.3

Shares controlled by RTZ:

Through Preston Mines Limited	44.0	
Through Tinto Holdings Limited	16.0	
Through Thornwood Investments Limited and Tinto Holdings Limited		48.7
	<u>100.0</u>	<u>100.0</u>

SCHEDULE II

THE RIO TINTO ZINC
CORP. LTD.
Canadian Corporate Structure



SCHEDULE III

EFFECT ON CANADIAN RESIDENT SHAREHOLDER OF BRINCO

Comparison of the treatment of \$1,000 of CFLCo operating income distributed through a corporate chain to the ultimate shareholders under the present and proposed tax systems

		Present System		Proposed System	
		Deferred tax	Current tax	Deferred tax	Current tax
		\$	\$	\$	\$
<div>CFLCo</div> <div>↓</div> <div>Brinco</div> <div>↓</div> <div>To a Canadian resident who is:</div>	Operating profit	1,000.00	1,000.00	1,000.00	1,000.00
	Tax payable: (Note 1)				
	Deferred	272.50	-	225.00	-
	Current	-	272.50	-	225.00
	Available for dividend	<u>727.50</u>	<u>727.50</u>	<u>775.00</u>	<u>775.00</u>
<div>a closely held corporation</div>	Tax paid	-	-	387.50	137.50
	Available for dividend	<u>727.50</u>	<u>727.50</u>	<u>387.50</u>	<u>637.50</u>
<div>a widely held corporation</div>	Tax paid	-	-	96.88	284.37
	Net after tax income	<u>727.50</u>	<u>727.50</u>	<u>290.62</u>	<u>353.13</u>
	Percentage reduction			<u>60%</u>	<u>51%</u>
<div>an individual with a marginal rate of:</div>	Tax paid	-	-	-	166.67
	Net after tax income	<u>727.50</u>	<u>727.50</u>	<u>387.50</u>	<u>470.83</u>
	Percentage reduction			<u>47%</u>	<u>35%</u>
<div>20%</div>	Tax paid (refunded)	-	-	(77.50)	72.50
	Net after tax income	<u>727.50</u>	<u>727.50</u>	<u>465.00</u>	<u>565.00</u>
	Percentage reduction			<u>36%</u>	<u>22%</u>
<div>40%</div>	Tax paid	145.50	145.50	38.75	213.75
	Net after tax income	<u>582.00</u>	<u>582.00</u>	<u>348.75</u>	<u>423.75</u>
	Percentage reduction			<u>40%</u>	<u>27%</u>

Note 1: CFLCo's effective tax rate is at present 27.25% due to the refund of only 95% of Federal tax.

SCHEDULE IV

EFFECT ON NON-RESIDENT SHAREHOLDER OF BRINCO

Comparison of the treatment of \$1,000 of CFLCo operating income distributed through a corporate chain to the ultimate shareholders under the present and proposed tax systems

	Present System		Proposed System	
	Deferred tax	Current tax	Deferred tax	Current tax
	\$	\$	\$	\$
Operating profit	1,000.00	1,000.00	1,000.00	1,000.00
Tax payable: (Note 2)				
Deferred	272.50	-	225.00	-
Current	-	272.50	-	225.00
Available for dividend	727.50	727.50	775.00	775.00
Tax paid	-	-	387.50	137.50
Available for dividend	727.50	727.50	387.50	637.50
To a non-resident who holds his investment:				
Through a closely held corporation				
Tax paid (Note 1)	109.13	109.13	140.47	337.34
Net after tax income	618.37	618.37	247.03	300.16
Percentage reduction			60%	51%
Through a widely held corporation				
Tax paid (Note 1)	109.13	109.13	58.13	237.29
Net after tax income	618.37	618.37	329.37	400.21
Percentage reduction			47%	35%
Directly				
Tax paid (Note 1)	109.13	109.13	58.13	95.63
Net after tax income	618.37	618.37	329.37	541.87
Percentage reduction			47%	12%

Note 1: Includes non-resident withholding tax at 15% of dividend paid.

Note 2: CFLCo's effective tax rate is at present 27.25% due to the refund of only 95% of Federal tax.

SCHEDULE VLORNE MINING CORPORATION LIMITED

Comparison of discounted cash flow
assuming location in various jurisdictions

Rate of discount 10%; Copper @ 46¢

\$MLN to nearest .5

	<u>Canada Present System</u>	<u>Canada Proposed System</u>	<u>Australia</u>	<u>South Africa</u>	<u>United States</u>
Cash flow from operations after repaying loans	88.5	70.0	79.5	76.0	85.5
Received by Tinto Holdings	23.5	12.5	21.5	20.5	20.0
Percentage reduction under proposed system		47%			
Percentage by which the return in other countries would exceed the return under Canada's pro- posed system			72%	64%	60%

Note: The above figures were calculated after paying mining taxes and provincial or state royalties.

SCHEDULE VI

EFFECT ON R.T.Z. IN RESPECT OF LORNEX

Comparison of the treatment of \$1,000 of Lornex operating income distributed through a corporate chain to the ultimate shareholders under the present and proposed tax systems

	Present System			Proposed System		
	Tax exempt \$	Deferred Tax \$	Current Tax \$	Deferred Tax \$	Current Tax Note 1 \$	Current Tax Note 2 \$
LORNEX						
Operating profit	1,000	1,000	1,000	1,000	1,000	1,000
Tax payable:						
Deferred	-	333	-	500	-	-
Current	-	-	333	-	333	500
Available for dividend	1,000	667	667	500	667	500
RIO ALGOM						
Tax paid	-	-	-	167	111	-
Available for dividend	1,000	667	667	333	556	500
PRESTON MINES						
Tax paid	-	-	-	-	-	-
Available for dividend	1,000	667	667	333	556	500
TINTO HOLDINGS						
Tax paid	-	-	-	83	139	125
Available for dividend	1,000	667	667	250	417	375
15% non-resident withholding tax	150	100	100	37	62	56
RTZ						
Received by RTZ	850	567	567	213	355	319
Effective rate of Canadian tax	15%	43%	43%	79%	65%	68%

Notes:

- (1) Tax will be payable at effective rate of 33-1/3% during period in which earned depletion is available or deduction from income.
- (2) Tax will be payable at effective rate of 50% after all earned depletion has been deducted from income.

SCHEDULE VII

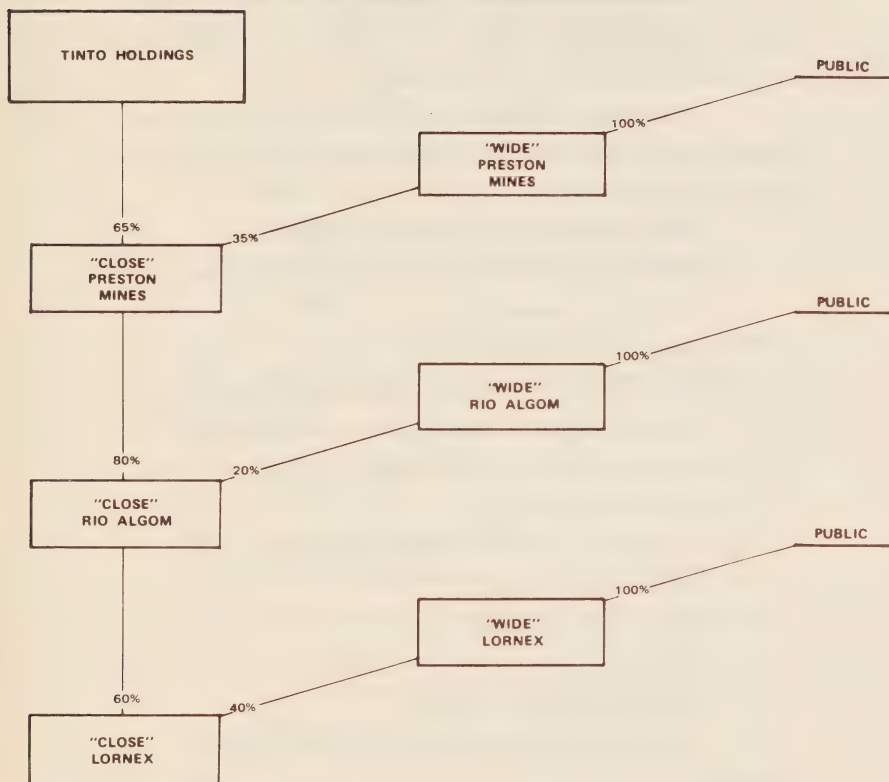
EFFECT ON R.T.Z. IN RESPECT OF CFLCO

Comparison of the treatment of \$1,000 of CFLCo operating income distributed through a corporate chain to the ultimate shareholders under the present and proposed tax systems

		Present System		Proposed System	
		Deferred tax \$	Current tax \$	Deferred tax \$	Current tax \$
<div style="display: flex; flex-direction: column; align-items: center;"> <div style="border: 1px solid black; padding: 2px; margin-bottom: 5px;">CFLCo</div> <div style="margin-bottom: 5px;">↓</div> <div style="border: 1px solid black; padding: 2px; margin-bottom: 5px;">Brinco</div> <div style="margin-bottom: 5px;">↓</div> <div style="border: 1px solid black; padding: 2px; margin-bottom: 5px;">Thornwood</div> <div style="margin-bottom: 5px;">↓</div> <div style="border: 1px solid black; padding: 2px; margin-bottom: 5px;">Tinto Holdings</div> <div style="margin-bottom: 5px;">↓</div> <div>RTZ</div> </div>	Operating profit	1,000.00	1,000.00	1,000.00	1,000.00
	Tax payable: (Note 1)				
	Deferred	272.50	—	225.00	—
	Current	—	272.50	—	225.00
	Available for dividend	727.50	727.50	775.00	775.00
	Tax paid	—	—	387.50	137.50
	Available for dividend	727.50	727.50	387.50	637.50
	Tax paid	—	—	96.88	284.37
	Available for dividend	727.50	727.50	290.62	353.13
	Tax paid	—	—	—	—
	Available for dividend	727.50	727.50	290.62	353.13
	15% non-resident withholding tax	109.13	109.13	43.59	52.97
	Received by RTZ	618.37	618.37	247.03	300.16
	Effective rate of Canadian tax	38%	38%	75%	70%

Note 1: CFLCo's effective tax rate is at present 27.25% due to the refund of only 95% of Federal tax.

CHART OF TYPICAL RTZ CANADIAN
CORPORATE STRUCTURE UNDER
WHITE PAPER PROPOSALS



APPENDIX "F"

NAME: THE RIO TINTO-ZINC CORPORATION LIMITEDSUBJECT: Integration

Analysis of Appendix "E" by Senior Advisor

The Brief is submitted by The Rio Tinto-Zinc Corporation Limited - a United Kingdom company with over 100,000 shareholders of whom 77% are residents of the United Kingdom.

The company, through a group of subsidiary and associated companies carry on operations in the United Kingdom, Canada, Australia, Africa and the United States.

The investments of the company in Canada are:

- (a) 100% ownership of Tinto Holdings which company owns directly or indirectly.
- (b) 87% of Thornwood Investments.
- (c) 43% (87% of 49%) of British Newfoundland Corporation.
- (d) 25% (43% of 57%) of Churchill Falls (Labrador) Corp. Ltd.
- (e) 43% (87% of 49%) of British Newfoundland Exploration Ltd.
- (f) 81% of Preston Mines.
- (g) 52% (16% + 81% of 44%) of Rio Algom Mines Ltd.
- (h) 52% of Poirier Mines
- (i) 30% of Anglo Rouyn Mines Ltd.
- (j) 19% of Lornex Mining Corporation Ltd.
- (k) 52% of Atlas Steels Company.

The operations of the complex of Canadian companies consist in:

- (a) Mining - uranium, copper.
- (b) Steel production.
- (c) Mineral exploration.
- (d) Power development.

Rio Tinto Zinc Corporation Limited through its 100% ownership in Tinto Holdings (a Canadian company) owns 100% of Holding companies in South Africa which hold mining interest there

and also through its investments in Preston Mines and Rio Algom Mines Ltd. (Canadian companies) owns a controlling interest in United States Holding companies, holding various mining interest in the United States.

The first eleven pages of the Brief provide a history of the company, its investments, development, and its interests in other countries, and policies. On page 11, the Brief states:

- (a) "few comments are made which affect companies in general and which it is expected will be covered fully in submissions by others."
- (b) "some matters of crucial significance to the company's future activities in Canada are only mentioned briefly as this material is covered fully in separate briefs submitted by BRINCO and RIO ALGOM."

The Brief confines itself to submission on the integration proposals contained in the White Paper and deals with its impact in the following areas:

- (1) On operating companies.
- (2) On shareholders.
- (3) On income from foreign sources.
- (4) On corporate structures.

The Brief on pages 13 to 20 deals with the integration proposals as they affect:

- (a) Churchill Falls (Labrador) Corporation Limited - a public utility company.
- (b) British Newfoundland Corporation Limited - a holding company and,
- (c) Rio Algom Mines Ltd. and Lornex Mining Corporation Ltd. - mining companies.

On pages 20 to 25, the Brief deals with the integration proposals as they affect Shareholders under the following heading:

- (a) Dividend distributions.
- (b) 5 year revaluation.
- (c) Corporate Reorganizations and Inter Group transfers of assets, and
- (d) "Staledating" of tax credit in widely held corporations.

On pages 26 and 27 the Brief deals with the proposals on income from foreign sources.

And finally, on pages 27 to 33, the Brief deals with corporate reorganization problems.

The Brief on pages 27 to 33, outlines the reasons for the present structure of the organization and points out:

- (1) "This corporate structure is necessary because of the substantial public participation in RTZ's Canadian companies and has no adverse tax effect under the present Canadian tax provisions where dividends between taxable Canadian corporations are tax free." (Page 27 of the Brief).
- (2) The main reasons for the form of existing corporate structure are:
 - (a) dividend policy - to meet requirements of minority shareholders without conflicting with requirements of parent company.
 - (b) United Kingdom foreign exchange control.
 - (c) United Kingdom taxes.
 - (d) Desire for Canadian participation.
 (Pages 28 and 29 of the Brief).

- (3) Possible reorganization.

The Brief points out the manner in which it would be necessary to reorganize, and the possible adverse effects of such a reorganization.

(Pages 29 to 33 of the Brief).

The Brief concludes on pages 33 to 36 with Suggestions and Conclusions and the attention of the Committee is drawn to the following remarks:

- (1) It must be ensured that the combination of provincial and federal taxes on mines be at a level consistent with creating the incentives to which the White Paper refers. (Page 33 of the Brief).
- (2) It also seems reasonable that shareholders should receive creditable tax for the full amount of all federal and provincial taxes. (Page 34 of the Brief).
- (3) It may be suggested that the extra deduction for exploration expenses and new mine facilities be increased by a factor greater than the proposed one third and be deductible up to the full extent of income. (Page 34 of the Brief).
- (4) It may also be suggested that the expenses qualifying for such extra deduction be broadened to include expenditures on existing facilities as would occur in the typical development of an oil field. (Page 34 of the Brief)
- (5) "The proposals impose a heavy and inequitable tax penalty on foreign investors who have for good reasons chosen corporate structures under which investments in widely-held corporations are held through Canadian holding companies." (Page 35 of the Brief).
- (6) "The penalty of such corporate structures is greatly magnified if the operating company distributes dividends which do not carry creditable tax." (Page 35 of the Brief).
- (7) "It is unlikely that reorganizations of existing corporate structures to overcome such penalties can take place. Even when they can, they will experience many difficulties and have serious adverse effects on both resident and non-resident investors." (Page 35 of the Brief)
- (8) "The corporate structures dictated by the proposals appear inappropriate for both the resident and non-resident investor." (Page 35 of the Brief).

Standing Senate Committee

- (9) "The proposals have a noticeable impact on the rates of return now available from mining ventures in Canada, and the combination of provincial and federal taxes leave little if any incentive effect." (Page 35 of the Brief).
- (10) "Some reduction in combined federal and provincial taxation of Canadian mining operations is necessary if any incentive effects are to be retained." (Page 36 of the Brief).
- (11) "The proposals for inter-corporate dividends should be amended to ensure that non-resident investors are fairly treated." (Page 36 of the Brief).
- (12) "Equity dictates that the proposals with respect to public utilities be amended to overcome the severe penalties imposed on investment on those companies. (This is more fully dealt with in the Brinco brief.)" (Page 36 of the Brief).
- (13) "Tax on capital gains should be imposed only upon realization." (Page 36 of the Brief).

The attention of the Committee is drawn to the following remarks:

- (1) "The most severe burdens on RTZ's activities in Canada are caused by the integration proposals. It is submitted that any acceptable integration proposal should be neutral in so far as groups structures are concerned. In other words, the ultimate shareholders should be left in exactly the same position as if they had invested directly in the individual operating companies in the group. The proposals in the White Paper, however, impose heavy penalties on non-resident shareholders who have encouraged substantial domestic share participation in their operating companies and adopted corporate structures suited to this participation. It should be emphasized

that these penalties would not be suffered under the proposals if the non-resident were to hold his interest directly in the operating companies, a situation which would be relatively easy to achieve if domestic participation in the enterprise had not been encouraged.

In essence the penalties referred to above arise for the following reasons:

- (a) The income of an operating company might not, in accordance with various proposals in the White Paper, carry creditable tax when paid to a shareholder. Examples of this are utility income and income from foreign subsidiaries in treaty countries. This income is, however, subjected to tax when it is eventually passed on to the operating company's resident shareholders.
- (b) Due to the differing degrees to which integration is applied to widely-held and closely-held corporations, additional tax always arises when a dividend is paid from the former to the latter even if it is paid out of profits that have been fully taxed. This proposal is particularly severe when a U.K. group such as RTZ has structured its Canadian interests to accommodate Canadian participation." (Pages 11, 12 and 13 of the Brief).
- (2) "It is not clear, under the proposed tax system, whether tax rebates from Newfoundland which would be received tax free by CFLCo, would in turn be free of tax to Brinco. We understand that this is the intention but the wording in the White Paper does not make clear how this result is to be accomplished." (Page 16 of the Brief).
- (3) "Even if distributions of these funds are exempt from tax in Brinco's hands they would appear to be taxable when they are, in turn, distributed to Brinco shareholders, with the result that the tax is merely shifted to the Brinco shareholders." (Page 17 of the Brief).

- (4) "Churchill Falls will have very large capital expenditures qualifying for capital cost allowances. The projections on which the financing of the project was based show that by the year 2000, CFLCo's distributable income will exceed the income upon which it has paid tax by approximately \$100 million as a result of claiming capital cost allowances in excess of depreciation recorded in the accounts."
(Page 17 of the Brief).
- (5) "If dividend distributions are made under these circumstances, they will be fully taxable in Brinco's hands even though full tax will eventually be paid on all income of CFLCo as and when book depreciation equals capital cost allowances. The extra taxes which would result in such circumstances will mean that CFLCo will delay paying dividends until they can be paid out of taxed income." (Page 17 of the Brief)
- (6) "As such, the real effect of the White Paper proposals, in this regard, is not that they will raise additional tax but that they will unduly restrict the cash flow to be received by Brinco from CFLCo and thus restrict the dividends paid to British Newfoundland shareholders."
(Pages 17 and 18 of the Brief).
- (7) "The present value of the cash flow of the Lornex mine under the present and proposed Canadian tax systems can be compared with the value of the discounted cash flow of an assumed identical mine in Australia, in South Africa and in the United States, countries notable for their mining opportunities. The table in Schedule V makes this comparison with respect to return to the operating company and also to a holding company in each country. It is significant that whereas Canada's present system allows a somewhat greater return from a mining venture than the systems in the other countries, the proposals would reduce the return in Canada to a level considerably below that of the other countries."
(Page 19 of the Brief).

- (8) "Under the existing corporate structure, dividends from operating companies in the RTZ group pass through one or more widely-held corporations and eventually to a closely-held Canadian corporation wholly owned by RTZ. Under the proposals, where such distributions are received by widely-held corporations, they would be taxed at the rate of 33-1/3% to the extent that they do not carry creditable tax. When they are further passed on to a closely-held corporation, the effective rate of tax would be increased to 50%. The effect of the proposals is to nullify in the hands of the investor the tax treatment accorded to the underlying operation and to penalize the form of corporate structure often adopted by non-resident investors." (Page 21 of the Brief).
- (9) "A further effect on inter-corporate distributions under the proposals is that a closely-held corporation pays additional tax of 25% of dividends received from a widely-held corporation even though the widely-held corporation is fully taxed and such tax is creditable. When the non-resident withholding tax is also taken into account, the total effective rate of Canadian tax on the underlying operating profits can become in excess of 70%. These effects are illustrated in Schedules VI and VII." (Pages 21 and 22 of the Brief).
- (10) "5 year revaluation
Because there is substantial Canadian participation in RTZ's Canadian undertakings, RTZ's shareholdings in Canada are in widely-held corporations and as such would be subject to the five year revaluation proposal. The five year revaluation proposal would not apply if RTZ followed a policy of operating through wholly-owned Canadian subsidiaries.
The five year revaluation proposal raises a number of

problems, many of which have been dealt with by others. We would, however, like to point out that to the extent that earnings are retained by subsidiary companies they would tend to be reflected in the five year revaluations and be effectively taxed under this provision. As a result the adverse effects of the integration proposals resulting from taxation at the shareholder level of earnings not taxed in the corporation could not be avoided by simply refraining from making distributions (see heading Dividend distributions above). We would also point out that the quoted market value for shares of a widely-held subsidiary engaged in developing natural resources could substantially exceed the real value to the holding company based on anticipated cash flow with the result that the holding company would be taxed on a notional gain which it has no hope of realizing through return on its investment. If the corporation were to sell shares from a large block, it is most unlikely that it could realize the market value.

Although the tax burden on the holding company is extremely heavy, it would appear even heavier to the non-resident investor since capital gains tax imposed on a revaluation basis would not be creditable in any foreign country against the capital gains tax imposed in the foreign country since foreign countries do not in these circumstances impose tax upon unrealized capital gains.

In any event it is hoped that if taxation of capital gains is imposed in Canada, Canada will negotiate treaties to avoid double taxation in this area." (Pages 22, 23 and 24 of the Brief)

- (11) "Stale dating" of tax credits in widely-held corporations
The reasons for requiring that creditable tax be distributed to shareholders within 2½ years seem to apply only to closely-

held corporations, and we think that the application of this proposal to widely-held corporations should be reconsidered. In many cases the needs of resident shareholders and non-resident shareholders may conflict. A non-resident direct investor is unlikely to be affected by staledating since his tax credit position is determined by the foreign law. At the same time the non-resident may be taxable on stock dividends. (The position of a U.K. investor is not entirely clear and may vary due to the circumstances.)" (Page 25 of the Brief).

- (12) "We welcome the suggestions for flow-through of foreign withholding taxes (White Paper 6.27) as removing an impediment to Canadian companies with foreign shareholders becoming substantial international corporations. However, the effect of the integration proposals as set out above unfortunately imposes a greater impediment to this desirable objective." (Page 26 of the Brief).
- (13) "Under the White Paper proposals set out in paragraph 6.15 a company such as Rio Algom could receive dividends from its foreign operating subsidiaries in treaty countries free of Canadian tax. Further, foreign withholding tax on such dividends up to a maximum of 15 percentage points could flow through for eventual credit in the hands of Rio Algom's shareholders. Unfortunately, however, dividends paid by Rio Algom out of foreign dividends which had borne no Canadian tax would not carry any creditable tax and would be fully taxable in the hands of shareholders such as Tinto Holdings except for the possible flow-through of 15 percentage points of foreign withholding tax." (Pages 26 and 27 of the Brief).

There is attached the usual summary of existing tax laws, White Paper proposals and principal points of the Brief.

APPENDIX "G"

BRIEF

TO THE

SENATE COMMITTEE

ON BANKING, TRADE

AND COMMERCE

THE FEDERAL GOVERNMENT'S

PROPOSALS FOR TAX REFORM

**ELECTRONIC INDUSTRIES ASSOCIATION OF CANADA
LES INDUSTRIES ELECTRONIQUES DU CANADA**

The Electronic Industries Association of Canada welcomes the opportunity to place before the Government the view of the Association membership on the "Proposals for Tax Reform" brought down by the Minister of Finance on November 7, 1969.

This Association commends Mr. Benson, Minister of Finance, on submitting the White Paper to the public for a complete airing.

The Electronic Industries Association of Canada (EIAC) is a voluntary association, having over 100 member companies. The industry employs 60,000 people and its gross sales for 1969 will exceed \$1 billion. EIAC was formed for the purpose of fostering the electronics industry in Canada. As is recognized by most world authorities, Canada is one of very few nations with sufficient capability to begin the electronic era on a sound basis. For this reason, as leaders of Canada's future, the EIAC feels compelled to participate actively in any tax reform programme proposed for the nation. The EIAC agrees with the necessity for tax reform. We believe that the tax system, in addition to supporting the public sector, should be designed to act as a stimulant of economic growth, a creator of productivity and competitive advantage, in relation to other countries.

This Association has been alarmed by the huge size of the Government sector which now accounts for nearly one-third of the economy. It is dismayed at proposals which would enhance the Government sector at the expense of the private sector.

The Association sincerely believes that there is need to curb Government encroachment on the private sector and to sharpen rather than dull the incentives for productivity, profit, savings, investments and control of inflation. Therefore, the Association respectfully submits that the White Paper be reviewed and reconstituted with new proposals dealing with all components of the public sector of the Gross National Product. In preparing such a proposal, the EIAC puts forth the following considerations to be used as guidelines:

1. The Association emphasizes that the Government should set a limit of 25% as the percentage of the Gross National Product which would accrue from taxes to the public sector of the economy and should undertake not to tax beyond that limit.
 - a) That scope of current and past Government commitments for future spending be held to 40% of the allowable limit set out in No. 1 above.
 - b) That incentives be used to spur lagging sectors of the economy.
 - i) That welfare be considered the responsibility of Government and private enterprise jointly: An incentive scheme be developed to curb unemployment, the cost of which should be borne primarily by private enterprise as a direct cost - like Canada Pension and Supplemental Unemployment Insurance Benefits.
2. A system within the framework of free enterprise be developed to give people resident in Canada an edge when competing with other technically advanced nations of the world.
 - a) That the Country offer tax advantages to skilled "middle income" people to locate in Canada.

- b) The Association feels that one (principal) residence should be excluded from capital gain tax calculation and that the limit on personal property exemption should be raised from the proposed \$500.00 to several thousands of dollars to decrease administration of the tax act and exclude tax assessors from the homes of the nation.
 - c) That the accumulation of wealth in the private sector be encouraged through incentives for productivity, profits, savings, and investments.
- 3. Bursaries and scholarships should be tax exempt.
- 4. The Electronics Industries Association accepts the principle of a capital gains tax. However, the EIAC recommends that the capital gains tax should be levied at a lower rate than proposed, namely, a capital tax of 15% long-term (six months or more) and 25% short-term. The EIAC also suggests the reduction of succession duties, otherwise the burden of capital gains and succession taxes will be unbearable and would result in the inevitable change of control in small companies, upon the death of the principal owner.
- 5. EIAC does not accept the principle of "Valuation Day" and the five-year deemed realization of capital gains. The EIAC believes that the unworkable system of periodic re-evaluation should be changed to payment of taxes on realized gains only. Further, the EIAC does not accept the principles of deemed realization when an individual leaves the country. Again, the capital gains tax should be applied only when assets are sold and a gain is realized. In turn, capital losses should be tax deductible.
- 6. The lower rates of taxation should apply to a corporation's first \$35,000 of profit.
The Association feels very strongly that a method must be found for assisting the small young corporations in becoming big and if the 21% tax rate for small corporations earning under \$35,000 a year is removed, some other substitute, like a fast write-off, be introduced to assist in the economic growth of these companies.
- 7. It seems to us that such "Nothings" as Patents, Copyrights, Licenses, etc., do indeed diminish in value with time and as the market for product involved becomes satisfied or supplanted by competitive products. Consequently, we consider that they should be treated as depreciating assets regardless of other consideration.
- 8. Entertainment and Related Expenses.
The need to be competitive must be recognized in considering entertainment expenses. Marketing is so international in scope that Canadians would be put at a disadvantage by the proposal to disallow entertainment expenses when competing against foreigners not so restricted.
Business has a choice between personal contact (which involves entertainment and convention expenses) or impersonal efforts, notably advertising.
In our opinion, all such expenses are a legitimate charge against operations and should be an allowable deduction from the income they help produce. To the

extent that club and convention expenses are entertainment expenses related to the promotion of a business and thus to earning income, they should be allowable. Abuse and excessive use can and should be curtailed.

9. The Association finds the stated objectives of the White Paper on International income desirable, however, we feel that more could be done to develop our industry - both domestically and internationally, if the investment requirements for foreign-controlled corporations were 10% rather than 25%. Further, that foreign tax credits be carried forward for a period of at least five years and be retroactive for a period of at least three years.

Lastly, the nature of the electronics industry requires international cooperation and will involve many multi-national corporations. Broader incentives and tax treaties should be encouraged.

The Electronic Industries Association of Canada is as vitally concerned with the welfare of the Country as any singular group could be. We trust that the Government will accept our critique of the White Paper as a sincere desire of the Association membership to advance Canada's economic and technical status.

Canada's future needs electronics and the EIAC looks to the Government of this country to provide an atmosphere where a viable electronics industry can grow. The electronic industries invest more than sixty million dollars annually in research and development in Canada. As the world's demands for electronic capability grow, so Government and industry must be prepared to recruit, develop and keep the necessary skills; not drive them away.

The EIAC repeats - it favours tax reform which contains more reward for initiative rather than further controls and less substance for the private sector of the economy.

MEMBER COMPANIES

OF THE

ELECTRONIC INDUSTRIES ASSOCIATION OF CANADA

CONSUMER PRODUCTS DIVISION

Canadian Admiral Corp. Ltd.
Canadian Westinghouse Co. Ltd.
Electrohome Ltd.
Philco-Ford of Canada Ltd.
RCA Ltd.

Canadian General Electric Co. Ltd.
Clairtone Sound Corp. Ltd.
Fleetwood Corp.
Philips Electronics Industries Ltd.

COMPONENTS DIVISION

Aerovox Canada Ltd.
 Audio Transformer Co. Ltd.
 Burndy Canada Ltd.
 Canadian General Electric Co. Ltd.
 Canadian Westinghouse Co. Ltd.
 Centralab Canada Ltd.
 Cramco Solder Alloys Ltd.
 Delhi Metal Products Ltd.
 Electronic Craftsmen Ltd.
 El-Met-Parts Ltd.
 Erie Technological Products of Canada Ltd.
 Ferritronics Ltd.
 Graphico Precision Works Ltd.
 Honeywell Controls Ltd.
 Johnson Matthey & Mallory Ltd.
 Lake Engineering Co. Ltd.
 Lightning Circuits Division
 Mallory Battery of Canada Ltd.
 McNeill Electronics Ltd.
 Neosid (Canada) Ltd.
 Philips Electronics Industries Ltd.
 Quality Hermetics Ltd.
 Radio Speakers of Canada Ltd.
 Renfrew Electric Co. Ltd.
 Space Circuits Ltd.
 Standard Coil Products (Canada) Ltd.
 Sylvania Electric (Canada) Ltd.
 Trim-Line Connectors Ltd.
 Varian Associates of Canada Ltd.
 Welwyn Canada Ltd.

Allen-Bradley Canada Ltd.
 Automatic Winding Corp. Ltd.
 Canada Wire and Cable Co. Ltd.
 Canadian Stackpole Ltd.
 Capacitors of Canada (1958) Ltd.
 Corning Glass Works of Canada Ltd.
 CTS of Canada Ltd.
 Elco Connectors (Canada) Ltd.
 Electrovert Mfg. Co. Ltd.
 Emanuel Products Ltd.
 Federal Wire and Cable Co. Ltd.
 General Instrument of Canada Ltd.
 Hammond Manufacturing Co. Ltd.
 ITT Cannon Electric Canada
 Kester Solder Co. of Canada Ltd.
 Lightning Fastener Co. Ltd.
 Magnetic Metals of Canada Ltd.
 Marsland Engineering Ltd.
 Microsystems International Ltd.
 Owens-Kimble Ltd.
 Precision Electronic Components
 Radio Components Ltd.
 RCA Ltd.
 Smallwood S.G. Ltd.
 Sprague Electric of Canada Ltd.
 Superior Electronics Inc.
 Texas Instruments Inc.
 United-Carr Canada Ltd.
 Ward Leonard of Canada Ltd.

ELECTRONICS DIVISION

Ampex of Canada Ltd.
 Aviation Electric Ltd.
 CAE Industries Ltd.
 Canadian General Electric Co. Ltd.
 Canadian Motorola Electronics Ltd.
 Cascade Electronics Ltd.
 Collins Radio Co. of Canada Ltd.
 Croven Ltd.
 ESE Limited
 Farinon Electric of Canada Ltd.
 Garrett Manufacturing Ltd.
 International Systcoms Ltd.
 KA-ME-CO Automation Electronics Ltd.
 Lenkurt Electric Co. of Canada Ltd.
 Northern Electric Co. Ltd.
 Philips Electronics Industries Ltd.
 Pylon Electronic Development Co. Ltd.
 Raytheon Canada Ltd.
 Richmond Hill Laboratories Ltd.
 Spar Aerospace Products Ltd.

Andrew Antenna Co. Ltd.
 Benco Television Associates Ltd.
 Canadian Admiral Corp. Ltd.
 Canadian Marconi Company
 Canadian Westinghouse Co. Ltd.
 Central Dynamics Ltd.
 Computing Devices of Canada Ltd.
 EMI Electronics Canada Ltd.
 Fanon Electronics of Canada Ltd.
 Ferranti-Packard Ltd.
 IBM Canada Ltd.
 ITT Canada Communications Div.
 Leigh Instruments Ltd.
 Litton Systems (Canada) Ltd.
 Northern Radio Mfg. Co. Ltd.
 Pye Electronics Ltd.
 Racal (Canada) Ltd.
 RCA Ltd.
 Sinclair Radio Laboratories Ltd.
 TMC Canada Ltd.

APPENDIX "H"

NAME: ELECTRONIC INDUSTRIES ASSOCIATION OF CANADA

SUBJECT: White Paper Proposals.

Analysis of Appendix "G" by Senior Advisor

This brief is submitted by the Electronic Industries Association of Canada, an association of over 100 companies, employing 60,000 people and with gross sales in 1969 of over \$1 billion.

The brief points out that the association agrees with the necessity for tax reform. It then makes a number of observations and comments.

On page 1 of the brief:

- "(1) This Association has been alarmed by the huge size of the Government sector which now accounts for nearly one-third of the economy. It is dismayed at proposals which would enhance the Government sector at the expense of the private sector.
- (2) The Association sincerely believes that there is need to curb Government encroachment on the private sector and to sharpen rather than dull the incentives for productivity, profit, savings, investments and control of inflation.
- (3) The Association respectfully submits that the White Paper be reviewed and reconstituted with new proposals dealing with all components of the public sector of the Gross National Product.

Standing Senate Committee

- (4) The Association emphasizes that the Government should set a limit of 25% as the percentage of the Gross National Product which would accrue from taxes to the public sector of the economy and should undertake not to tax beyond that limit.
- (5) That scope of current and past Government commitments for future spending be held to 40% of the allowable limit set out in No. 4 above.
- (6) That incentives be used to spur lagging sectors of the economy.
- (7) A system within the framework of free enterprise be developed to give people resident in Canada an edge when competing with other technically advanced nations of the world.
- (8) That Canada offer tax advantages to skilled "middle income" people to locate in Canada.
(Page 2 of the brief).
- (9) That the accumulation of wealth in the private sector be encouraged through incentives for productivity, profits, savings and investment.
(Page 3 of the brief).
- (10.) The E.I.A.C. repeats - it favours tax reform which contains more reward for initiative rather than further controls and less substance for the private sector of the economy."

The brief also comments upon certain **specific** proposals contained in the White Paper.

On Page 2 of the brief it makes the following comments respecting Capital Gains:

- "(1) The Association feels that one (principal) residence should be excluded from capital gain tax calculation and that the limit on

personal property exemption should be raised from the proposed \$500.00 to several thousands of dollars to decrease administration of the tax act and exclude tax assessors from the homes of the nation.

- (2) The Electronic Industries Association accepts the principle of capital gains tax. However, the E.I.A.C. recommends that the capital gains tax should be levied at a lower rate than proposed, namely, a capital tax of 15% long-term (six months or more) and 25% short-term.
- (3) E.I.A.C. does not accept the principle of "Valuation Day" and the five-year deemed realization of capital gains.
- (4) The E.I.A.C. believes that the unworkable system of periodic re-evaluation should be changed to payment of taxes on realized gains only.
- (5) The E.I.A.C. does not accept the principles of deemed realization when an individual leaves the country.
- (6) The capital gains tax should be applied only when assets are sold and a gain is realized. In turn, capital losses should be tax deductible."

The brief makes the following comments on pages 2 and 3, respecting the following subjects:

- (1) Bursaries
"Bursaries and scholarships should be tax exempt."
- (2) Lower rate of tax on first \$35,000
"The Association feels very strongly that a method must be found for assisting the small

Standing Senate Committee

young corporations in becoming big and if the 21% tax rate for small corporations earning under \$35,000 a year is removed, some other substitute, like a fast write-off, be introduced to assist the economic growth of these companies."

(3) Amortization of "nothings".

"It seems to us that such "Nothings" as Patents, Copyrights, Licenses, etc., do indeed diminish in value with time as the market for product involved becomes satisfied or supplanted by competitive products. Consequently, we consider that they should be treated as depreciating assets regardless of other consideration."

(4) Entertainment and related expenses.

"The need to be competitive must be recognized in considering entertainment expenses. Marketing is so international in scope that Canadians would be put at a disadvantage by the proposal to disallow entertainment expenses when competing against foreigners not so restricted. Business has a choice between personal contact (which involves entertainment and convention expenses) or impersonal efforts, notably advertising.

In our opinion, all such expenses are a legitimate charge against operations and should be allowable deduction from the income they help produce. To the extent that club and convention expenses are entertainment expenses related to the promotion of a business and thus earning income, they should be allowable. Abuse and excessive use can and should be curtailed."

(5) International Income.

"The Association finds the stated objectives of the White Paper on International income desirable, however, we feel that more could be done to develop our industry - both domestically and internationally, if the investment requirements for foreign-controlled corporations were 10% rather than 25%. Further, that foreign tax credits be carried forward for a period of at least five years and be retroactive for a period of at least three years.

Lastly, the nature of the electronics industry requires international cooperation and will involve many multi-national corporations. Broader incentives and tax treaties should be encouraged."

The attention of the Committee is drawn to the following comments made in the brief:

- (1) "The accumulation of wealth in the private sector should be encouraged through incentives for productivity, profits, savings and investments.

(Page 2 of the brief)

- (2) "The E.I.A.C. also suggests the reduction of succession duties, otherwise the burden of capital gains and succession taxes will be unbearable and would result in the inevitable change of control in small companies, upon the death of the principal owner."

(Page 2 of the brief)

There is no summary attached as no specific comments are offered respecting the White Paper proposals.

APPENDIX "I"

THE SOCIAL IMPLICATIONS OF TAX REFORM

A submission by the Canadian Welfare Council to the Standing Senate Committee on Banking, Trade and Commerce, on Proposals for Tax Reform, the federal government's White Paper on income tax

55 Parkdale Avenue
Ottawa May 1970

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THE SOCIAL IMPLICATIONS OF TAX REFORMS U M M A R Y

(References in the text are to the main Statement)

A. General Considerations

The Council's Basic Position (pp. 3-5): The Council's chief concern with the "Proposals for Tax Reform" is how they affect lower income people: do they assist the objective of "a greater degree of social justice and equality of opportunity ... for all Canadians"? Taxation raises funds for programs necessary to reach this objective and is an important component in the redistribution of national wealth. The Council stresses the key importance of basing the tax system on ability to pay; people should only be taxed on income in excess of what is required for the basic necessities of life and taxation should be progressive.

Taxation and an Adequate Standard of Living (pp. 5-8): "Canada's social security system should provide, as a matter of right, sufficient income to support an adequate standard of physical and social well-being for all individuals and families." Taxation and social programs need to be considered together.

Limitations in Assessing the White Paper (pp. 8-10): It is unfortunate that the White Paper has been presented in advance of the promised proposals for reforms in social security and social development programs. Without this information, it is difficult to judge the basic equity of the tax proposals. It is also unfortunate that certain forms of taxes that are regressive (e.g., real property, sales tax) are not dealt with in the White Paper; all forms of taxes must be taken into account in framing an equitable tax system

Definition of Income (pp. 10-11): The White Paper does not provide the clear definition of income that is required if the personal income tax is to have the pivotal position assigned to it in the Canadian tax system; it is thus inconsistent in its approach to what should be included in income.

B. Rate Structure and Revenue

The Maximum Marginal Tax Rate (pp. 12-16): The Council believes that a top limit of about 50 per cent, to be reached at \$24,000 taxable income, is against the general principle of "fairness" stated in the White Paper itself; it would be a tax concession to the better-off to offset taxation of capital gains which is long overdue. The argument that the 50 per cent limit is necessary to provide work incentive for the wealthy is not borne out by a number of studies. The Canadian Welfare Council concedes that "ostentatiously" high rates could cause a feeling of ill-treatment and strenuous efforts at tax evasion, which is socially undesirable and should be avoided. However, in fairness to other groups, "the top marginal rate should be appreciably higher than 50 per cent, and the 50 per cent marginal rate should be reached beyond the level of \$24,000 now proposed, with tax rates adjusted so as to reduce the steepness of the progressivity for groups below that level while producing the revenue required". The rate structure should also be regularly reviewed for necessary adjustment to revenue needs while maintaining the relative position of taxpayers.

Revenues and Expenditures (pp. 16-21): The importance is stressed of considering the use of revenue before deciding the amount to be raised. The Council urges the need for more investment in social security and social service programs; this is not "wasteful" and unproductive, but a necessity for economic as well as humanitarian reasons, and should be so viewed "not only with regard to tax reform but in reaching decisions on public expenditures and the revenue required to meet them".

C. Specific Considerations

Increase in Personal Exemptions (pp. 22-23): The Council questions the adequacy of the proposed amounts in relation to inflation since 1949 (when previous levels were set), and warns they should not be taken to represent "poverty lines", thus becoming an artificial means of setting low standards. The Canadian Welfare Council agrees that tax exemptions given to everyone can be made equitable through the rate structure; when the tax system is used for social payments to selected groups (e.g., dependents' deductions), tax credits are fairer. (See Appendix for extended discussion of this point.)

The Family as a Tax Unit (p. 24): The Council regrets that consideration of this was postponed.

Deductions for Dependents (pp. 24-26): Consideration of this was also postponed, pending the social security and social development proposals; however, the Council records its view that family allowances are a more satisfactory method of meeting family economic responsibilities for children than use of the income tax system. It recommends that the deductions for children be eliminated and family and youth allowances substantially increased; they should be made taxable so that the net-of-tax amount received should be positively related to need. While dependents' deductions of any kind continue, they should take the form of tax credits.

Child Care Expenses (pp. 26-28): If regarded as "an expense incurred in earning a living", the White Paper proposal can properly be dealt with by tax exemptions (see Appendix, p. 4). The Council warns of possible unfortunate effects if (as claimed) the deduction is also intended as a social measure; it must not be regarded as adequately meeting the problem of day care for children. Nevertheless, the Council accepts the proposal, at least as a short-term measure pending better provisions, with two suggested amendments: a) the situation of a non-working parent in the home but unable to care for the children should be covered, and b) the amounts should be reviewed when more accurate information on the costs of day care is available and there should be periodic review and adjustment for current costs.

Employment Expenses (pp. 28-29): The Canadian Welfare Council endorses "more rigorous limits to check 'expense account living'", and the deduction for relocation expenses for new jobs. It recommends elimination of the proposed standard expense deduction for wage and salary earners as inequitable; if kept for administrative reasons it should be a flat rate of \$50 with no reference to percentage of income. The Council recommends no limit on expenses above that amount, but says that claims should be supported by vouchers, and careful controls on what is eligible should be established.

Other Deductions and Exemptions (pp. 29-30): The Council agrees with proposed changes re exemptions of certain "married" persons. It recommends elimination of the \$500 exemption for those over 70, etc., as not an equitable method of dealing with these needs; a more satisfactory substitute should be instituted.

Charitable Donations (pp. 30-31): The Canadian Welfare Council recommends abolition of the standard optional deduction and no change in the 10 per cent limit on deductions of donations.

Medical Expenses (pp. 31-33): The Canadian Welfare Council agrees in general with the White Paper proposals but urges that the provisions of the Income Tax Act recognize any health care expenditure not covered by a public or private plan if prescribed by a physician and duly authenticated (e.g., for a visiting homemakers, practical nurse, or care in a nursing home).

Taxation of Income Security Benefits (pp. 33-34): The Council agrees with taxation of unemployment insurance with deductibility from income of employee contributions, and recommends the same treatment for other income security programs, provided that there is an increase in benefit levels which at least prevents a decline in after-tax benefits for lower income groups.

General Income Averaging Option (p. 34): The Canadian Welfare Council recommends this should apply to less substantial income increments than proposed and also to reductions in income.

Capital Gains Tax (p. 35): Strongly supported.

Principal Residences (p. 35): The Canadian Welfare Council generally approves the proposal, but the level of exemption and improvement allowances may be inadequate in certain areas, and the "rollover" provision should apply to all sales, with strict safeguards to prevent abuse.

Withholding Tax (p. 36): This should not be greater than the Canadian income tax would have been at the same level of income, and international treaties should ensure appropriate tax credits by the country of residence.

THE SOCIAL IMPLICATIONS OF TAX REFORMIntroduction

The Canadian Welfare Council is a national nongovernment organization made up of some 480 public and private agencies, business corporations and labour organizations, church and citizen groups, and about 1,300 individuals, interested in policies and programs which affect individual well-being and social development. Through planning, consultation, research and public education, the Council seeks to promote for the people of Canada social security measures and social services, government and nongovernment, that are adequate in extent, of high quality and soundly administered. The Council's briefs and statements endeavour to influence public policy towards this end.

As with all Council-wide policy statements, this submission has been prepared by a special committee of interested and informed persons appointed by the Council's Board of Governors, which represents, as far as possible, the variety of organizations, interests and viewpoints included in the Council's membership. The statement was reviewed in draft by the Board which authorized

(1) References in the text, unless otherwise identified, are to Proposals for Tax Reform. E. J. Benson, Minister of Finance. (Ottawa: Queen's Printer, 1969).

the Executive Committee to deal with the final document and formal approval was given at a special meeting of the Executive on May 7, 1970. Obviously, with a membership as diversified as the Council's, unanimous agreement can never be claimed on any major policy statement, and official approval is always based on consensus.

Since all taxes are ultimately paid by people, every facet of taxation and tax policy has, in a broad sense, social policy implications. However, the Council has limited its discussion to some general principles, related to taxation, and to certain aspects of the personal income tax which have the most direct and widespread impact on families and individuals. Neither time nor resources permitted analysis of such matters as corporation taxes and special business exemptions, nor of the question of the division of taxing powers among the various jurisdictions. The Council also recognizes, as stated later in this submission, that a sound economy, based on a satisfactory level of productivity, is a prerequisite to the social development of any country. Without this, social policies and programs, however desirable, cannot be adequately implemented.

A. General ConsiderationsThe Council's Basic Position

1. The Canadian Welfare Council works for the social rights and needs of all people. It has a special concern for the people whose interests generally are less well represented than those of other groups in society. In the context of taxation, these are the lower income groups who are in danger of being overlooked in the hurly-burly of attack and counter-attack which has greeted the White Paper. In short, the Council declares its own "special interest" in its approach to the "Proposals for Tax Reform" - how do they affect lower income people?⁽²⁾
2. Behind any basic philosophy of social policy lie the questions: What are our social goals? What kind of society do we want, and are we prepared to pay for? In the Council's view:

The objective of social policy is human well-being. This has two aspects. On the one hand, the individual must be guaranteed the freedom and opportunity to carry responsibility, so far as he is able, for meeting his own needs and aspirations. On the other, the achievement of human well-being, especially under today's conditions,

(2) Some criteria for identifying lower income groups are given in footnote (6), p. 5, and footnote (23), p. 22 below.

is as much a social as an individual responsibility. Only through collective planning and action can the conditions be established that will enable all people to realize their potential (3) and contribute creatively to society.

3. To reach this objective we need to establish a greater degree of social justice and equality of opportunity and an adequate standard of living for all Canadians. It is through the tax system that most of the funds for paying for such developments are found. Taxation is also an important component in the redistribution of national wealth that is essential to (4) achieving our social goals.

4. The aims of the White Paper are stated as follows: (1.6, p. 15):

A number of goals and standards have guided the government in its approach to reform. They include a fair distribution of the tax burden based upon ability to pay; steady economic growth and continuing prosperity; the recognition of modern social needs; widespread understanding of and voluntary compliance with tax laws, combined with enough detail to block loopholes; and, finally a system that can and will be used by the provinces as well as Canada.

These aims are in line with the Council's own position as (5) expressed in its statement, Social Policies for Canada, Part I.

(3) Social Policies for Canada, Part I. (Ottawa: The Canadian Welfare Council, 1969), p. 2.

(4) This was also the view of the Carter Commission.

(5) Op. cit.

5. From the Council's point of view the main principle that should govern the tax system is that it should be based on ability to pay, thus achieving fairness in the distribution of the tax burden while assisting the redistribution of money to benefit lower income groups. Ability to pay means that people should only be taxed on income in excess of what is required for the basic necessities of life and that such taxation should be progressive. Distribution of the tax burden according to ability to pay is essential in working toward fair treatment of people at all income levels. This is particularly important for lower income groups since poverty is characterized not only by economic and often physical hardship but by a deep sense of inequality in the society. An inequitable system of taxation is one reinforcing factor in this complex, critical and chronic situation.

Taxation and an "Adequate Standard of Living"

6. The shocking fact that, according to the latest statistics, almost one-fifth of all Canadian families and two-fifths of (6) unattached individuals live near or below the "poverty line"

(6) Income Distribution and Poverty in Canada, 1967, Preliminary Estimates (Ottawa: Dominion Bureau of Statistics, 1969), p. 11. Based on the criterion that any individual is in the low-income group if he has to spend 70 per cent or more on the necessities of life, i.e., food, shelter, and clothing.

clearly indicates that there is a serious imbalance in the distribution of wealth in this country. This is confirmed by DBS statistics which show that in 1965 (again the latest figures available) the 20 per cent of Canadian non-farm individuals and families who were in the lowest income level had 4.6 per cent of the total income while the top 20 per cent had 41.1 per cent. (7) According to the Economic Council of Canada, there was practically no change in the distribution of income through the society as a whole between 1951 and 1965 although average family income increased very rapidly in that period. (8)

7. The Canadian Welfare Council has recommended that "Canada's social security system should provide, as a matter of right, sufficient income to support an adequate standard of physical and social well-being for all individuals and families". (9)
- As the Prime Minister pointed out in the Debate on the 1968 Throne Speech, there is a need to define "the essential

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- (7) Income Distributions: Incomes of Non-Farm Families and Individuals in Canada, Selected Years, 1951-65. Catalogue No. 13-529, Occasional. (Ottawa: Dominion Bureau of Statistics, 1969). Table 12, p. 78.
 - (8) Fifth Annual Review, Economic Council of Canada. (Ottawa: Queen's Printer, 1968), p. 107.
 - (9) Social Policies for Canada, Part I, op. cit., pp. 28-30.

components of a minimum standard of satisfactory living - not a subsistence standard but one that allows for dignity and decency".⁽¹⁰⁾ Moreover, this minimum (adequate) standard is not an absolute; it varies with particular needs and responsibilities and with regions. Also, in measuring poverty there is a strong element of relativity: for example, of comparing an individual's income with others' in the same society. As the Council has stated elsewhere, "poverty consists of relative deprivation of major physical and social needs and of the person's sense of perception of deprivation".⁽¹¹⁾

8. It is clear that "neither exemptions from tax nor credits against tax can ensure that every Canadian has a minimum income The income tax system as such cannot be used to help people without income - those who most need help".⁽¹²⁾ Nonetheless, the tax system obviously has a part to play in the total approach to an adequate standard of living. This approach must include not only tax relief for lower income groups through exemptions or other means, but the provision

(10) Debates of the House of Commons. (Ottawa: Queen's Printer, September 25, 1968), p. 68.

(11) Urban Need in Canada, 1965. (Ottawa: The Canadian Welfare Council). Section I., "Overview", pp. 8-9.

(12) Report of the Royal Commission on Taxation. (Ottawa: Queen's Printer, 1966). Vol. 3, p. 21. This applies to the normal concept of the system. However, the tax system can be used to help those without taxable income through a negative income tax (c.f. the guaranteed income supplement for the aged) or through rebates on tax credits.

of sufficient tax money to fund necessary programs both of income security (e.g., family allowances, old age security) and of social services (e.g., health care).⁽¹³⁾

9. It was for this reason that the Council recommended a comprehensive study of Canada's social security system. The Council stressed the importance of considering as a whole:

... the net redistributive effect of taxes and transfer payments, the relationship of the social security system and changes in the tax system (proposed or contemplated)... (14)

Limitations in Assessing the White Paper

10. The Council is handicapped in commenting on the taxation proposals by the fact that the White Paper on them has been presented in advance of the promised proposals for reforms in social security and social development programs. The two sets of proposals need to be considered together in order properly to assess their total impact on the well-being of Canadians. As has been said in a critique of the Carter Report:

(13) The Council endorses a guaranteed annual income approach but points out that "the level of payments and the coverage of ... (such a) program will be crucial in determining the extent to which a piecemeal network of other social security programs can be dispensed with". Social Policies for Canada, Part I, op. cit., p. 29.

(14) Ibid., p. 39.

To achieve equity in the sense of a reduction in income inequality is one of the major objectives of modern government. The two principal instruments are taxation and expenditures, and it is the combination of the two that determines the net effect on equity... For example, a steeply progressive tax schedule combined with expenditures that benefit the well-to-do (highways, power boat facilities, airport construction, subsidies to cultural activities) could be less equitable than a moderately progressive tax schedule combined with expenditures that benefit lower income groups (public hospitals, low rent housing, services to the aged and indigent). (15)

Without information about what is planned in the way of expenditures, it is difficult to judge the basic equity of the tax proposals. This point is further discussed in section B below.

11. It is unfortunate also that certain forms of taxes were not dealt with in the White Paper's proposals. For example, as the White Paper itself notes (1.20, p. 8), the real property tax "bears heavily on those with low incomes, if we take into account its effect on rents". Lower income people are usually renters rather than owner-occupiers, and the White Paper proposals continue the substantial tax discrimination in favour of owner-occupiers - rents must be paid out of after-tax

(15) A. J. Robinson, "The Concept of Equity in the Carter Report", Public Finance in Canada: Selected Readings. (Toronto: Methuen Publications, Toronto, 1969), p. 30.

income while the net imputed income to the owner-occupier is untaxed. Compulsory social insurance contributions, a form of tax, (e.g., for unemployment insurance, the Canada Pension Plan, health care premiums) reduce the progressivity of the income tax. The sales tax is "inferior in fairness to the income tax" (1.20, p. 8). The Council believes that all forms of taxes, direct and indirect, federal, provincial and municipal must be taken into account in framing an equitable tax system.

Definition of Income

12. Given the insistence of the White Paper on the pivotal position of personal income taxation in the Canadian tax system, the definition of income as the index of ability to pay is of central importance. What is required is the definition in the Canadian Income Tax Act of a consistent theoretical concept of income to which only rare and explicit exceptions are permitted on grounds of insuperable
(16)
administrative difficulties.
13. What the White Paper proposes is a further development of the traditional Canadian system of approaching a definition as an

(16) The Carter Commission proposed a comprehensive concept of income, subject only to certain exceptions on grounds of administrative feasibility.

ad hoc summation of different forms of accretions to economic "well-being" or "power".

14. The result is inconsistency in the White Paper's approach to what should be included in income. For example, it is proposed that unemployment insurance benefits be taxed but not a number of other income security benefits. (This is further discussed in paragraphs 49 and 50, p.33 below). Moreover, although it is proposed to check "expense account living" of some taxpayers in the professional and business group, no upper limit has been set on these deductions as is suggested for the new expense allowances of wage and salary earners.

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15. The White Paper on Taxation presents us with only one side of the coin of the "Just Society" that the Government of Canada appears to be in the process of minting. It certainly seems in its general approach to move towards greater equity. Nevertheless, the White Paper has not, in the Council's view, achieved this end in a number of instances although it takes some positive steps towards further income redistribution. However, pending the publication of the proposals on social security and social development, our comments on specific proposals on taxation must be within a limited context.

B. Rate Structure and RevenuesThe Maximum Marginal Tax Rate

16. The rationale for increasing the rates on taxable income to offset the regressive effect of the proposed increased tax concessions is sound, otherwise "the wealthy would be freed from paying high rates of tax on amounts of income equal to the exemption increases ... and the loss of revenue would be substantial" (2.29, pp. 18-19). The White Paper also states that "Fairness ... requires that people with higher incomes, people who are better off, should be expected to pay in taxes a larger share of their incomes than persons with lower incomes" (1.9, p. 6). The real question to be asked is: do the actual proposals for distributing the tax increases among various income groups bear out these positions?
17. The rate increases begin with the first tax level and cause tax increases above current levels (depending on circumstances): for example, from \$3,000 taxable income for a single taxpayer with no dependents (Table 7, p. 30) and from \$12,000 for a family with two dependent children and both parents working (Table 10, p. 33). With the limiting of the rate to about 50 per cent of all taxable incomes from \$24,000, a substantial tax relief will be provided to the top income group before capital gains are taken into account. The White Paper states

that, once capital gains are taxed (although, effectively, only at half rates on shares of widely-held Canadian corporations) "The tax system would be significantly more progressive even without the ostentatiously high rates now in use" (1.31, p. 10).

18. There will also, of course, be capital gains involved in income well below the \$24,000 taxable level which will mean that where there is the same proportionate income split (between gains and other income) such people will be paying more in relation to the higher income people than they would have under the present rate structure. Even a \$25,000 taxable-income person may resent paying at the same marginal rate as one with \$100,000 or \$400,000. To the middle-income group (on whom the heaviest burden of the new tax system will fall) and to those with low incomes, tax concessions to the wealthy to offset, at least to a degree, payments on capital gains that should in equity have been taxed long since can scarcely appear equitable. It is doubtful if they would be comforted by the reflection that "only" \$40 million would be lost in revenue through reduction of the top rates, even though \$345 million would be added through taxing capital gains.
19. The chief reason for proposing the new tax rates for high-

income groups is the effect they might have on productivity and therefore the economy. There are two broad issues here:

a) "To what extent Canadian income taxes affect the ability

of Canada to retain able and highly trained Canadians who could emigrate to the U.S. and to attract skilled and able persons from the U.S. and elsewhere" (8.38, p. 91). Both the Carter Commission and the White Paper reject the argument that high tax rates play a significant part in emigration.

b) "The influence of the proposed tax changes on the effort men and women put into their work" (8.36, pp. 90-91).

Although the White Paper states that "The economic effects of taxing gains have been appraised and are considered unlikely to interfere significantly with incentives to save and invest in Canada" (1.28, p. 10), it accepts the Carter view that this will only hold true for high-income people if the top marginal tax rate for other income is not more than 50 per cent. It is not considered that incentives in the other groups will be much affected by higher taxes (8.37, p. 91).

20. This position on incentives is based on the "conventional wisdom" that economic gain is the primary, if not the exclusive, motivation for work - and most so for higher income people. Yet studies of corporation workers and assembly line

workers alike suggest that other motivations - social conditioning, job satisfaction, the wish for power - are at least of equal importance. To quote a commentary on the Carter Report:

It is perhaps fair to wonder, in the light of a substantial body of evidence in the literature that work effort is unrelated to tax liability, why the Commission found it necessary to recommend such drastic rate reductions. The Commission's argument that high marginal rates do affect work incentives is certainly not impressive: "... although we have no evidence to support our contention, we are convinced that high marginal personal rates of tax do have a negative effect on labour, managerial and professional effort."

This conclusion is inconsistent with the findings of the special study done for the Commission on the subject. (17)

21. The real argument against "ostentatiously" high rates must rest on a judgement as to what "larger share of their income" the wealthy should pay. How much of the income dollar is it fair (and equity must apply to all tax groups) to take from

(17) J. Cutt, "Equity and Growth", Public Finance in Canada, op. cit. p. 42. The "special study" referred to is: The Effects of Income Taxation on Work Choices, Study No. 4, Royal Commission on Taxation, op cit. Other studies with similar findings include: Barlow, Brazer and Morgan, Economic Behaviour of the Affluent (Washington, D.C., Brookings Institute, 1966); and George F. Break, "Income Taxes and Incentives to Work", American Economic Review, pp. 529-549, September 1957.

high-income people? A sense of being unfairly treated can lead to even more strenuous efforts than heretofore to circumvent the law (as witness conditions under prohibition) which all the "stopping of loopholes" in the world will not prevent. This is socially undesirable.

22. The Council therefore concedes that "ostentatiously" high tax rates should be avoided. However, it questions the maximum rate proposed in the White Paper. In fairness to other groups, the top marginal tax rate should be appreciably higher than 50 per cent, and the 50 per cent marginal rate should be reached beyond the level of \$24,000 now proposed, with tax rates adjusted so as to reduce the present steepness of the progressivity for income groups below that level while producing the revenue required. Once an equitable relationship between different taxpayers has been established in the rate structure, the structure should be regularly reviewed for adjustment necessary to meet revenue needs without changing the relative position of taxpayers.

Revenues and Expenditures

23. The White Paper states (8.1 and 8.3, p. 85) that "the proposals have been designed to produce approximately the same revenue in the first year of their operation as would the existing tax system" and that "the system would produce

5 per cent more revenue in the fifth year than the first". Much debate has centered on this fifth year "surplus" which many claim would in fact be far higher and (by definition) therefore bad. The Council would raise a question in reverse: will revenue in the first, fifth, or any given year be adequate to meet necessary public programs?

24. The apparent paradox of deciding what to do with revenue after rather than before it is raised has been commented on by the Council (paragraph 10, pp. 8-9), above and many others. It has been pointed out that:

Once the transition period was over, the government would then have the attractive option of choosing whether to reduce marginal tax rates, remove entirely the double taxation of corporate income, reduce the size of the outstanding government debt, or to increase housing, regional expansion or other high priority expenditure programs. Since the White Paper did not spell out which of these alternatives the government would be likely to follow, it is impossible to make unconditional forecasts of what the final effects of the tax reforms will be. (18)

In line with its basic position, the Council believes that a major "final effect" of tax reform should be increased

(18) J. F. Helliwell, "Inflation and Tax Reform", The Canadian Tax Journal, pp. 124-130, March-April, 1970.

investment for social purposes which is still far from adequate in Canada. As the White Paper observes (1.13, p. 7): "Our increasingly urban society imposes on governments and other public authorities demands and conditions which strain to the limit their ability to finance and to execute their activities. The reformed income tax must further the proper development of this changing society".

25. The Council has stated that: "Public policies that can produce a dynamic economy capable of supporting full employment, sound manpower practices and adequate wage levels are prerequisites to the Council's recommendations on social security"⁽¹⁹⁾. But it has urged the need for more investment in social security and social service programs, and it rejects the all too widely held view that the use of public moneys for such purposes is "wasteful" while expenditure to meet, for example, consumer demand that may often not be genuine but artificially created (e.g., by advertising) is "productive". Even on purely economic grounds, failure to improve the financial and other conditions of life for a large segment of our population is expensive and short-sighted. As the Economic Council of Canada has stated,

(19) Social Policies for Canada, Part I. op. cit., p. 28.

poverty can impose very large costs on society: "It has been estimated in the United States that one poor man can cost the public purse as much as \$140,000 between the ages of 17 and 57".⁽²⁰⁾ No similar calculation has been made for Canada but it has been estimated that, in addition to the costs of assisting the poor, "the total of lost income, or lost output, which could be directly attributed to poverty (in Canada) in 1961 ... falls in a range of roughly \$1 billion to about \$2½ billion, depending on the assumptions made".⁽²¹⁾

26. The problem is, of course, one of choice among differing judgements as to Canada's social and economic priorities and goals. As an illustration of this point, we would refer again to "Inflation and Tax Reform".⁽²²⁾ The author demonstrates that under the White Paper proposals, there would be a net decrease in the aggregate savings ratio "whether general fiscal policy was used either to maintain budget balance or to maintain the level of aggregate demand" He goes on to state:

(20) Fifth Annual Review, op. cit., p. 105.

(21) Measuring the Cost of Poverty: Technical Document Supplementing Chapter 7 "Poverty" of the Sixth Annual Review (Ottawa, Economic Council of Canada, 1969), p. 11.

(22) J. F. Helliwell, op cit.

Ought we to regard this downward movement in the savings ratio as a good thing or a bad thing? If the Carter-type logic is extended further than it actually was in the Report, then we would conclude that the tax system ought to be neutral as between private choices, with the aggregate savings ratio just determined as the overall result of a lot of free private savings decisions. According to this logic, to argue against a more equitable and more neutral distribution of the tax burden amongst present taxpayers on the grounds that it would hurt savings and growth is a mistake. There is implicit in such an argument the assumption that we ought to be transferring more personal wealth to subsequent generations than we would be willing to do under a neutral tax system. Paradoxically, the argument that we ought to pass more wealth to the next generation, who in any case will be wealthier than we are, and may well be less materialistic, is made by many of the same people who are against redistribution of our present wealth in favour of those who probably need it much more than anyone in the next generation.

27. The Council urges the importance of ensuring that, in the words of the White Paper (1.10, p. 7), "investments needed for productivity and public purposes are not rejected in favour of less desirable alternatives just because of their tax consequences". We emphasize that "productivity" in this context should be viewed in its widest social as well as

economic sense, not only with regard to tax reform but in reaching decisions on public expenditures and on the revenue required to meet them.

C. Specific ConsiderationsIncrease in Personal Exemptions (2.4, p. 14)

28. The Council welcomes the removal of the 750,000 low-income people from the tax rolls that would result from the proposal to raise the income levels at which tax begins. But it seriously questions whether the amount of the exemptions is adequate since, as a result of inflation, the equivalent of the \$1,000 established for an individual in 1949 is \$1,600 in 1970 dollars (based on the Consumer Price Index), not the \$1,400 proposed.
29. The Council would emphasize that the proposed personal exemption levels must not be taken as indicating true "poverty lines". Even if adjusted for the equivalent to 1949 dollars, they would be below the revised "poverty lines" suggested by the Economic Council of Canada ⁽²³⁾ and below many social assistance standards. Indeed, the Council would warn against the use of personal exemption levels at any time to establish "poverty

(23) These revised "poverty lines" in dollars of 1968 purchasing power are: \$1,800 per year per single person; \$3,000 for a family of two; \$3,600 for a family of three; \$4,200 for a family of four; and \$4,800 for a family of five. Allowing for 5% reduction in purchasing power due to inflation in 1969, the new levels would be: \$1,890; \$3,150; \$3,780; \$4,410; \$5,040, just to stay even.

lines". Since these exemptions are a factor in the rate structure, they are not easily adaptable to meeting changing low-income needs or regional variations. They could thus become an artificial means of setting a low standard for, say, the application of a negative income tax should this be introduced, and perhaps of "freezing" it for a long period.

30. There has been considerable discussion about replacing exemptions with a system of tax credits as being more favourable to lower income groups. Under the present rate structure, the flat exemption approach is socially unsatisfactory, offering greater relief to those in higher tax brackets. However, the Council recognizes that equity can be achieved in a system of flat exemptions given to everyone (such as the basic personal exemption) by taking into account, in formulating the rate structure, any changes in the exemption levels (2.29-2.30, pp. 18-19). But it believes that, if the tax system is used as a way of making social payments to selected groups (e.g., dependents' deductions), tax credits are preferable to exemptions. (24)

(24) See Appendix, attached, and paragraphs 32 and 34, pp. 24-25, below.

The Family as a Tax Unit (2.5, pp. 14-15)

31. In its submission to the Carter Commission, the Council recommended that the income tax system should be revised to take "more adequate account of the fact that the normal earning and spending unit in society is the family, rather than a series of separate and distinct individuals".⁽²⁵⁾ This concept has such fundamental implications for the tax system that it is unfortunate that consideration of it has been postponed until the present proposals of the White Paper are dealt with. Particularly important for examination in this connection are the guidelines proposed in a study for the Carter Commission.⁽²⁶⁾

Deductions for Dependents (2.6, p. 15)

32. The government has deferred consideration of these until completion of the review of Canada's social security and social development programs. However, the Council wishes to record its view that family allowances are a more satisfactory

(25) Social Welfare and Taxation: Submission to the Royal Commission on Taxation. (Ottawa: The Canadian Welfare Council, 1963). Paragraph 2,a), p. 39.

(26) "Taxation of the Family", Studies of the Royal Commission on Taxation, No. 10. (Ottawa: Queen's Printer, 1966), pp. 129-131.

method of recognizing family economic responsibilities for children than tax exemptions which provide little or no recognition of family size among lower income families, and are completely useless to people who pay no taxes. Moreover, tax exemptions for dependents offer greater relief to those in higher income brackets since, unlike the universal basic exemption, they can only with great practical difficulty be adjusted to give an adequate degree of progressivity; this would require different rate structures by size of families.

33. The Council recommends that benefit levels should be increased substantially in the family and youth allowances programs. It also recommends that the tax exemption for dependent children should be eliminated and that the allowances should (27) be taxable as income. These two measures together would permit recovery of a substantial portion of the benefits from (28) those not requiring them.

(27) Based on Social Policies for Canada, Part I, op. cit., pp. 31-33. Also see paragraphs 49-50, p.33, below. Also Appendix, second last sentence, p. 5: "... (in place of tax relief for children, there should be) larger family allowances which in turn should be subject to income tax so that the net-of-tax amount received would be positively related to need".

(28) It would be possible to recover up to 100 per cent through using the tax reporting machinery to obtain refunds from people at certain income levels, as was indeed the procedure in the early days of the family allowances program.

34. As long as tax concessions for any kind of dependent are retained, the Council recommends that the exemptions be replaced by tax credits, for the reasons given in paragraph 32 above and in the Appendix.

Child Care Expenses (2.7, p. 15)

35. The principle of help with child care expenses to assist working parents, or a sole working parent, is one measure (previously endorsed by the Council) that can afford some help (29) in the vexed problem of day care of children. When regarded as an expense incurred in earning a living it can (30) properly be dealt with by tax exemptions as proposed.
36. However, the extent to which the proposal meets the social as well as economic needs (both are aims recognized in the White Paper) for improving the provision of day care services to children raises some questions. The whole matter of day care of children (which goes far beyond its relationship to "working mothers") has become most urgent, and demands

(29) Social Welfare and Taxation: Submission to the Royal Commission on Taxation. (Ottawa: The Canadian Welfare Council, 1963), p. 40.

(30) See Appendix, first full paragraph, p. 4.

consideration as a matter of broad social policy for all
(31) Canada.

The White Paper proposals could have unfortunate effects in that they are of little or no help to many low-income working mothers, and they may lead to increased charges for day care (as raises in old age benefits have led to increased rents and boarding costs) and perhaps to the lessening of public subsidies to day nurseries. Moreover, there is always the danger, in using tax deductions as a method of meeting social needs, of creating the illusion that a problem has been adequately dealt with and thereby delaying even longer the recognition of the necessity for more effective measures: in this instance, for greatly expanded day care services of acceptable quality, now and in the foreseeable future.

37. Nevertheless, the Council endorses the proposed deductions, at least as a short-term measure, pending more adequate long-term provisions, with two provisos:
- a) There may be a non-working parent in the home who is physically, mentally, or emotionally incapacitated and

(31) The Council will shortly complete a study of day care for children which will contain important policy recommendations.

unable to provide adequate care for the children; the working parent in this situation should be eligible for the deduction.

- b) While consideration of the adequacy of the proposed amount of the deductions must await more accurate information on the costs of day care to working mothers, the principle of regular periodic review in relation to adjustment for current costs should be accepted.

Employment Expenses

38. The Council endorses the proposal "to set more rigorous limits to check 'expense account living'" (2.11, p. 16). It is already on record as recommending that "certain types of expense allowances and company-provided fringe benefits" (32) should be included in income for tax purposes.
39. The Council believes that the proposed general deduction for wage and salary earners (of 3 per cent of gross employment income up to a maximum of \$150 per year) (2.12-2.13, p. 16) is not in the interests of equity between individual taxpayers since it gives a tax advantage to those who do not actually expend the funds. If some general exemption is essential for

(32) Social Policies for Canada, Part I., op. cit., p. 37.

administrative convenience (both for taxpayers and tax officials) the Council proposes that it should be limited to a flat rate of \$50, with no reference to percentage of income. Actual employment expenses above that sum should be allowed on the presentation of vouchers. The upper limit should be eliminated but there should be careful controls on what is eligible for deduction: i.e., excluded would be items that are normally required in all types of employment; included would be items that an employee is required to purchase in order to carry out his particular job.

40. The Council supports the proposed deduction for relocation expenses in connection with a new job (2.15, p. 16). This is in line with Department of Manpower mobility programs which we strongly support.

Other Deductions and Exemptions

41. The Council considers equitable the proposals for changing the conditions for a taxpayer claiming "the exemption of a married person under certain circumstances even though not married or married and separated" (2.16, p. 16), and agrees with reducing deductions for wives or dependents who have income of their own (2.17, pp. 16-17).
42. The Council takes the view that the additional \$500 exemption for those over 70, for the blind, or for a person confined to

a wheelchair (2.18, p. 17) is not an equitable nor the most effective method of dealing with the financial needs of these people since its help is slight or non-existent for many in the low-income group whose need is the greatest. The compassion on which the White Paper bases its retention of the exemption appears to evaporate as the need for it increases. A more satisfactory substitute should be instituted: e.g., through increased old age security and/or guaranteed income supplement payments, and increased allowances recognizing the extra costs that may arise from disability.

Charitable Donations (2.19, p. 17)

43. The White Paper leaves the current situation unchanged in the light of the improvements made in recent years in the arrangements for registration and regulation of charitable organizations. The Council commends these improvements but repeats its earlier recommendation that the \$100 standard exemption for charitable donations and medical expenses should be eliminated because it gives a tax advantage to those who do not incur these costs. ⁽³³⁾ However, if (as for employment expenses) some exemption is considered necessary

(33) Social Welfare and Taxation, op. cit., p. 34.

for administrative convenience, it should be reduced to \$50, particularly in view of the increased coverage now available through public health care programs. Logically, there should be separate standard deductions for charitable donations and medical expenses since the present deduction mixes voluntary and involuntary financial obligations and may well produce inequities among individual taxpayers. But administrative convenience may here again be the deciding factor.

44. The Council concurs in the decision to leave the limit on deductions of charitable donations for tax purposes at 10 per cent of income. Since average giving is now only about $1\frac{1}{2}$ per cent of income, increase in the ceiling would have little effect on total results but might offer inducement to abuse (e.g., through the setting up of unjustifiable charitable trusts on a large scale).

Medical Expenses (2.20, p. 17)

45. The Council is on record as endorsing comprehensive public health care plans "financed entirely out of general revenues since they are social programs designed to provide universal access to service benefits on a uniform basis". (34) It

(34) Social Policies for Canada, Part I., op. cit., p. 34.

agrees with the present position that no expenses recoverable from such public plans, or premiums paid towards them (as now occurs in some provinces), should be considered as medical expenses for income tax purposes. The White Paper proposal that "all medical expenditures for which a taxpayer has been reimbursed, or is entitled to be reimbursed" under private plans should also not be classified as medical expenses for tax purposes is logical and equitable.

46. The proposal that premiums paid to private plans should be treated as medical expenses for income tax purposes is justified, at least until the very considerable gaps in public health care benefits have been eliminated.
47. The White Paper fails to indicate whether relief granted on these conditions for medical expenses will be confined to those deductible items which are now recognized or will be extended to other legitimate health care expenditures. Among such services not in general covered by public or private plans are those of a visiting homemaker assisting the sick aged or a family when the housewife is ill, a practical nurse who is hired under similar circumstances, care in a nursing home. The Council believes that the provisions of the Income Tax Act should be extended to recognize any health care expenditure, not covered by a public or private plan, that is

incurred at the direction of a medical practitioner as defined in the Act, subject to the submission of satisfactory evidence.

48. The proposal that an employer's contribution towards a premium payable by an employee to a public medical care plan should be treated as a taxable benefit received by the employee is in line with the Council's views on definition of income. (35)

Taxation of Income Security Benefits (2.22-2.23, p. 18)

49. The Council has stated that:

Social security benefits are a type of "income" and should be added to other income for purposes of personal income tax, provided that other kinds of income that currently escape taxation are also included. (36)

The Council therefore agrees in principle with the White Paper proposal to tax unemployment insurance benefits with deductibility from income of employees' contributions.

50. However, it is essential, of course, that taxability of social security benefits which are now exempt should only be

(35) See paragraph 12, p. 10.

(36) Social Policies for Canada, Part I, op. cit., p. 37.

implemented in conjunction with an increase in benefit levels that at least prevents a decline in after-tax benefits for lower income groups. Such an adjustment should therefore be made along with the proposed tax change.

51. The same logic as for unemployment insurance should apply to other income security programs. It already does so for Old Age Security and the Canada Pension Plan; included also should be family allowances (as already mentioned above), workmen's compensation, war disability pensions and sickness cash benefits (available only under private plans at present). However, it may, as proposed in the White Paper, be desirable for practical reasons not to include social assistance payments based on assumed or measured calculation of need. It is theoretically possible to apply the taxation principle to them through a "book" calculation that will leave people where they were before financially, but may not be worth the administrative effort involved.

General Income Averaging Option (2.53-2.59, pp. 22-24)

52. The Council endorses the principle of general income-averaging but urges that it apply to less substantial income increments than what is indicated in the White Paper (2.56, p. 23), and that it also apply to reductions in income: e.g., on retirement or when forced to take a lower paid job.

Capital Gains Tax (pp. 36-44)

53. Capital gains are a major item in the kinds of income that currently escape taxation; taxation of them is strongly supported by the Council. ⁽³⁷⁾ Some implications of the White Paper proposals have been discussed above (section B, pp. 12-16).

Principal Residences (3.19-3.21, pp. 38-39)

54. The Council generally endorses the proposals with regard to tax on sales of the above, although the amounts proposed for the exemption and for improvement allowance may be inadequate in certain areas. However, the Council recommends that the "rollover" provision should apply to all sales, not just those of people who move "from one area to another within Canada in connection with a change of job" (3.20, p. 39). Otherwise, real hardship may be worked on some families, particularly people who wish at the point of retirement to move to a new area, or even (for economy reasons) to different accommodation in their own area. Strict safeguards would be required for such a provision: e.g., a limit on the number of times it could be used (perhaps only once a year), purchase of the new house within a year, etc.

(37) Ibid.

Withholding Tax (6.36, pp. 76-77)

55. The Council is concerned with the possible effect of the withholding tax on low-income people: for example, pensioners who wish to live with or near relatives in another country. It is recommended that the withholding tax should not be greater than the Canadian income tax would have been at the same level of income and that international treaties ensure that appropriate tax credits be given by the country of residence.

APPENDIXTAX CREDITS VERSUS PERSONAL EXEMPTIONS AND DEDUCTIONS

(The following are comments on "Tax Credits", a memorandum in relation to the White Paper, "Proposals for Tax Reform", prepared, January 23, 1970, by the Department of Finance for submission to the House of Commons Committee on Finance, Trade and Economic Affairs)

In the first section (paragraphs 5-12), the supplementary paper on tax credits submitted by the Minister indicates that for exemptions or tax credits given to everyone (e.g., the basic exemption), it really does not make any difference whether exemptions or credits are used. The rate schedule has to be different in the two cases, but the effective marginal and average rates can be made the same under the systems.

The real issue is whether tax relief available only to some, such as for dependents, ought to be in the form of a tax credit or a tax exemption. We ought, at the outset, to draw a distinction between two reasons for giving tax relief for certain expenditures. One reason is to exempt from taxation expenditures which are necessary to earn the income which is being taxed. Such exemptions are implicit in the definition of taxable income from businesses, and the provision of child care or moving expense allowances are just logical extensions of the same principle to individuals.

The second reason is quite separate, and relates to a general social welfare policy. When tax relief is given for children, and other dependents, for the elderly, and for the blind, the reason is

not to cover expenses incurred in earning income but as a way of using the tax systems to make social welfare payments.

It is for this latter type of situation that tax credits are preferable to exemptions, since they provide the same amount of relief for each taxpayer regardless of his level of income. The exemption, on the other hand, reduces taxes by an amount proportional to the taxpayer's marginal tax rate, thus giving most relief to those with the highest incomes.

The memo from the Minister of Finance does not distinguish the two types of reason for giving tax relief, and uses reasons appropriate for expense deductions to analyze situations falling in the second category, where the deductions are in effect social welfare payments.

The proponents of tax credits have argued against exemptions because they give more relief to those with higher incomes, while the Department of Finance is arguing that the use of tax credits would force the recipients of dependents' deductions to pay at higher marginal tax rates than other taxpayers in the same economic circumstances. Who is wrong, and why?

There are two effects of substituting a credit for an exemption. On the one hand it increases the tax paid by those at higher incomes and reduces tax paid by those at lower incomes. At the same time, it increases the amount of income to which the given tax rate schedule is applied. But if we are giving the tax relief as part of the welfare system, then the appropriate measure of income is that

which takes no account of the special circumstances.

Consider two people with income net of allowable expenses of the same amount. If one had a dependent child and the other did not, and there were a system of tax credits for dependents, then both would have the same marginal rate of income tax. The average rate would be different for the two, of course, since the one with a child would get a tax credit, while the other would not. Under a system of tax exemptions, on the other hand, the person with a child would have a lower marginal tax rate of income tax if the exemption were large enough to reduce his or her income by enough to put it in a lower tax bracket. It is this fact which leads the Minister of Finance to prefer tax exemptions to tax credits. But why should people with the same income not have the same marginal tax rate? Because one has a dependent child, says the Minister's memo. But the tax credit is specifically intended to refund to the taxpayer the amount which we have collectively somehow decided is an appropriate subsidy from society as a whole to those who are incurring the direct expenses of raising children. If the credit is of the appropriate size, then there is no reason for the taxpayer with a dependent child to have a different marginal tax rate than the taxpayer without a dependent.

Consider also what the effects are when we compare the two systems for people with different incomes. The tax credit produces the same amount of tax relief for all those with dependent children, regardless of their income level. The exemption system,

on the other hand, means that the subsidy from society to the person raising a child is highest for those with the highest incomes and lowest for those with the lowest incomes. Neither tax credits nor exemptions are of any use to people with no taxable income unless there is some scheme for negative income tax payments. If there were such a scheme, then once again the tax credits would be an appropriate form.

Finally, consider the Minister's reference to the deduction for child care expenses. The child care deduction is apparently intended to cover expenses which are a necessary, or at least desirable, condition of earning the income which is being taxed. This is an example of a tax allowance given to offset necessary expenses; thus the exemption provides a more appropriate vehicle than the tax credit. If the tax credit were used in these circumstances, the working mother with a high income would be paying tax on more than her income net of child care expenses, while the mother with a lower income would be paying tax on less than her income net of child care expenses.

In conclusion, the case for the exemptions seems valid where the intent of the deduction is to permit a more appropriate definition of income net of necessary expenses, while tax credits are demonstrably fairer as a means of making social welfare payments through the tax system. However, like the family allowance, tax credits give money to people without regard to how much they need it. This suggests that tax credits for children ought to be dropped

entirely in favour of larger family allowances which in turn ought to be subject to income tax so that the net-of-tax amount received would be positively related to need. Nevertheless, although an ordinary system of tax credits for dependents is not directly related to need, it is clearly superior to a system of tax exemption, in which the tax relief offered is inversely related to need.

Committee on the Social Implications
of the White Paper on Taxation
The Canadian Welfare Council

APPENDIX "J"

NAME: CANADIAN WELFARE COUNCIL.

SUBJECT: White Paper Proposals affecting
individual well being and social
development.

Analysis of Appendix "I" by Senior Advisor

This brief is submitted by the Canadian Welfare Council a national non-government organization of some 480 public and private agencies, business corporations, labour unions, church and citizen groups and about 1,300 individuals.

The objects of the Council are to promote for the people of Canada social security measures and social services that are adequate in extent, of high quality and soundly administered.

The Council has limited its brief to some general principles related to taxation and to certain aspects of the personal income tax which have the most direct and widespread impact on families and individuals.

The brief discusses general considerations and the economic impact upon the position for those it seeks to assist in the first 21 pages and then proceeds to discuss a relatively few specific proposals.

The attention of the Committee is drawn to the following comments:

1. "The Council is handicapped in commenting on the taxation proposals by the fact that the White Paper on them has been presented in advance of the promised proposals for reforms in social

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security and social development programs. The two sets of proposals need to be considered together in order properly to assess their total impact on the well-being of Canadians."

(Page 8 of the brief)

2. "The Council believes that all forms of taxes, direct and indirect, federal, provincial and municipal must be taken into account in framing an equitable tax system."

(Page 10 of the brief)

3. "The White Paper on Taxation presents us with only one side of the coin of the "Just Society" that the Government of Canada appears to be in the process of minting. It certainly seems in its general approach to move towards greater equity. Nevertheless, the White Paper has not, in the Council's view, achieved this end in a number of instances although it takes some positive steps towards further income redistribution. However, pending the publication of the proposals on social security and social development, our comments on specific proposals on taxation must be within a limited context."

(Page 11 of the brief)

4. "The real argument against "ostentatiously" high rates must rest on a judgement as to what "larger share of their income" the wealthy should pay. How much of the income dollar is it fair (and equity must apply to all tax groups) to take from high-income people? A sense of being unfairly treated can lead to even more strenuous efforts than heretofore to circumvent the law (as witness conditions under prohibition) which all the "stopping of loopholes" in the world will not prevent. This is socially undesirable."

(Pages 15 and 16 of the brief)

5. "The Council theretore concedes that "ostentatiously" high tax rates should be avoided. However, it questions the maximum rate proposed in the White Paper. In fairness to other groups, the top marginal tax rate should be appreciably higher than 50 per cent, and the 50 per cent marginal rate should be reached beyond the level of \$24,000 now proposed, with tax rates adjusted so as to reduce the present steepness of the progressivity for income groups below that level while producing the revenue required. Once an equitable relationship between different taxpayers has been established in the rate structure, the structure should be regularly reviewed for adjustment necessary to meet revenue needs without changing the relative position of taxpayers."

(Page 16 of the brief)

The brief makes the following recommendations:

1. Deductions for dependents

- (a) "The Council recommends that benefit levels should be increased substantially in the family and youth allowances programs. It also recommends that the tax exemption for dependent children should be eliminated and that the allowances should be taxable as income. (27) These two measures together would permit recovery of a substantial portion of the benefits from those not requiring them. (28)"

(Page 25 of the brief)

- (b) "As long as tax concessions for any kind of dependent are retained, the Council recommends that the exemptions be replaced by tax credits, for the reasons given in paragraph 32 above and in the Appendix."

(Page 26 of the brief)

2. Employment Expenses.

"If some general exemption is essential for administrative convenience (both for taxpayers and tax officials) the Council proposes that it should be limited to a flat rate of \$50, with no reference to percentage of income. Actual employment expenses above that sum should be allowed on the presentation of vouchers. The upper limit should be eliminated but there should be careful controls on what is eligible for deductions: i.e., excluded would be items that are normally required in all types of employment; included would be items that an employee is required to purchase in order to carry out his particular job."

(Pages 28 and 29 of the brief)

3. Sale of principal residence.

"However, the Council recommends that the "rollover" provision should apply to all sales, not just of those people who move "from one area to another within Canada in connection with a change of job".

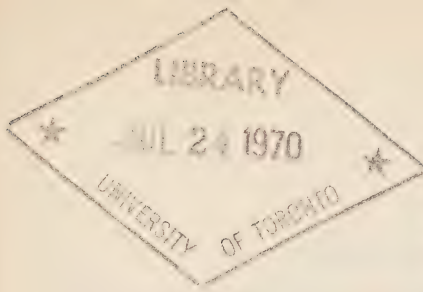
(Page 35 of the brief)

4. Withholding tax.

"It is recommended that the withholding tax should not be greater than the Canadian income tax would have been at the same level of income and that international treaties ensure that appropriate tax credits be given by the country of residence."

(Page 36 of the brief)

There is attached the usual summary of present law, White Paper proposals and principal points of the brief.



Government
Publications

Second Session—Twenty-eighth Parliament
1969-70

THE SENATE OF CANADA
PROCEEDINGS
OF THE
STANDING SENATE COMMITTEE
ON
BANKING, TRADE AND COMMERCE

The Honourable LAZARUS PHILLIPS, *Acting Chairman*

No. 31

WEDNESDAY, JUNE 10th, 1970

*Twenty-Fifth Proceedings on the Government White Paper,
entitled:*

"PROPOSALS FOR TAX REFORM"

WITNESSES:

(For list of witnesses see Minutes of Proceedings—Page 31:5)

APPENDICES:

- "A"—Brief from Canadian International Power Company Limited.
- "B"—Brief from The Canadian Mutual Funds Association.
- "C"—Brief from Investors Group Trust Co. Ltd.
- "D"—Brief from Texaco Canada Limited.
- "E"—Brief from the Pension Fund Society of the Bank of Montreal.
- "F"—Analysis of Appendix "E" by Senior Advisor.

THE STANDING SENATE COMMITTEE ON
BANKING, TRADE AND COMMERCE

The Honourable Salter A. Hayden, *Chairman*

The Honourable Senators:

Aird	Croll	Isnor
Aseltine	Desruisseaux	Kinley
Beaubien	Everett	Lang
Benidickson	Gélinas	Macnaughton
Blois	Giguère	Molson
Burchill	Grosart	Phillips (<i>Rigaud</i>)
Carter	Haig	Walker
Choquette	Hayden	Welch
Connolly (<i>Ottawa West</i>)	Hays	White
Cook	Hollett	Willis—(30)

Ex officio members: Flynn and Martin

(Quorum 7)

ORDERS OF REFERENCE

Extract from the Minutes of the Proceedings of the Senate, November 19, 1969:

"With leave of the Senate,
The Honourable Senator Martin, P.C., moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on Banking, Trade and Commerce be authorized to examine and report upon the White Paper intitled: "Proposals for Tax Reform", prepared by the Minister of Finance, and tabled in the Senate on Tuesday, 18th November, 1969.

After debate, and—

The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, December 19, 1969:

"With leave of the Senate,
The Honourable Senator Phillips (*Rigaud*), moved, seconded by the Honourable Senator Robichaud, P.C.:

That the Standing Senate Committee on Banking, Trade and Commerce be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—

The question being put on the motion, it was—
Resolved in the affirmative."

Extract from the Minutes of the Proceedings of the Senate, February 18, 1970:

"With leave of the Senate,
The Honourable Senator McDonald moved, seconded by the Honourable Senator Hayden:

That the Standing Senate Committee on Banking, Trade and Commerce have power to sit during adjournments of the Senate.

After debate, and—

The question being put on the motion, it was—
Resolved in the affirmative."

Robert Fortier,
Clerk of the Senate.

MINUTES OF PROCEEDINGS

WEDNESDAY, June 10th, 1970.

(49)

MORNING SITTING

Pursuant to adjournment and notice the Standing Senate Committee on Banking, Trade and Commerce met this day at 9:00 a.m. to further consider:

The Government White Paper entitled: "Proposals for Tax Reform".

Present: The Honourable Senators Aird, Aseltine, Beaubien, Benidickson, Burchill, Carter, Cook, Desruisseaux, Everett, Flynn, Haig, Hays, Hollett, Isnor, Molson, Phillips (*Rigaud*) and Welch—(17).

*The Honourable Senator Phillips (*Rigaud*) Acting Chairman in the Chair.

Present, but not of the Committee: The Honourable Senators Sullivan and Urquhart—(2).

In attendance: Roland B. Breton, Executive Secretary.

WITNESSES:

Canadian International Power Company Limited

Mr. J. Kazakoff, President;

Mr. W. M. Hickey, Chairman;

Mr. E. H. Campbell, Vice-President, Finance;

Mr. A. B. Creaghan, Secretary and Legal Counsel;

Mr. H. P. Crevier, Assistant to Legal Counsel.

The Canadian Mutual Funds Association

Mr. J. M. Godfrey, Q.C., President and President of United Accumulative Funds Ltd.;

Mr. J. D. McAlduff, Vice-President, Investors Group and Chairman, Taxation Committee;

Mr. C. Grant, Q.C., Counsel;

Mr. C. M. Bell, Executive Director;

Mr. W. R. McEwan, Vice-president, A.G.F. Management.

Investors Group Trust Co. Ltd.

Mr. J. N. W. Budd, President;

Mr. J. D. McAlduff, Executive Vice President;
Mr. B. J. Condy, Assistant Vice-President.
At 12:00 Noon the Committee adjourned.

AFTERNOON SITTING

2:15 p.m.
(50)

At 2:15 p.m. the Committee *resumed*.

Present: The Honourable Senators Aseltine, Beaubien, Benidickson, Bur-
chill, Carter, Cook, Desruisseaux, Everett, Haig, Hays, Hollett, Isnor, Molson,
Phillips (*Rigaud*) and Welch—(15).

*The Honourable Senator Phillips (*Rigaud*) *Acting Chairman* in the Chair.

WITNESSES:

Texaco Canada Ltd.

Mr. A. G. Farquharson, President;
Mr. D. F. Bentley, Vice-president and Legal Counsel;
Mr. O. C. Windrem, Tax Administrator.

The Pension Fund Society of the Bank of Montreal

Mr. S. A. Shepherd, Vice-President, Pension Plans, Bank of Montreal;
Mr. W. McLean, President, McLean, Budden Ltd., Investment Managers
and Consultants.
Mr. M. Riddell, Vice-President, Research, McLean, Budden Ltd.

Ordered: That the documents submitted at the meeting today be printed
as appendices to these proceedings, as follows:

- A—Brief from Canadian International Power Company Limited.
- B—Brief from The Canadian Mutual Funds Association.
- C—Brief from Investors Group Trust Co. Ltd.
- D—Brief from Texaco Canada Limited.
- E—Brief from the Pension Fund Society of the Bank of Montreal.
- F—Analysis of Appendix "E" by Senior Advisor.

At 4:30 p.m. the Committee adjourned to the call of the Chairman.

ATTEST:

Frank A. Jackson,
Clerk of the Committee.

THE STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE

EVIDENCE

Ottawa, Wednesday, June 10, 1970

The Standing Senate Committee on Banking, Trade and Commerce met this day at 9 a.m. to give further consideration to the White Paper entitled "Proposals for Tax Reform".

Hon. Lazarus Phillips (*Acting Chairman*) in the Chair.

Senator Phillips (*Rigaud*): Honourable senators, Senator Hayden is not able to be with us today, and I am wondering whether, with your approval, I may act in his place as Acting Chairman.

Hon. Senators: Agreed.

Senator Phillips (*Rigaud*): Thank you very much.

The Acting Chairman: Honourable senators, as you know, we have five groups who will be making representations here today. We will take them in this order: Canadian International Power Co. Ltd., The Canadian Mutual Funds Association, Investors Group Trust Co. Ltd., Texaco Canada Ltd., The Pension Fund Society of the Bank of Montreal.

I am stating that for the benefit of those who are here representing these companies, because obviously we will not be able to listen to all these briefs this morning. Our practice is usually to start at 9 sharp; we close at 12.30 and then re-convene at 2.15. I say that so that the gentlemen representing these companies will be able to guide themselves, to see how we get along from the point of view of when some of you will be heard in the afternoon, or possibly later this morning moving into the afternoon.

Honourable senators and gentlemen, the first brief is that from the Canadian International Power Co. Ltd., and I will ask the following gentlemen to come forward: Mr. J. Kazakoff, the President; Mr. W. M. Hickey, the Chairman; Mr. E. H. Campbell, the Vice-President, Finance; Mr. H. P. Crevier, Assistant to Legal Counsel; and Mr. Creaghan, Secretary and Legal Counsel.

Mr. Kazakoff, the practice of this committee is to request from you a summary of the brief, which of course has been read by all honourable senators. After such summary has been presented, we usually proceed by way of a seminar in question and answer, and perhaps you would, either on your own account or with your colleagues, allocate the questions so we can develop the subject matter of your brief. Would you like to start?

Mr. J. Kazakoff (*President, Canadian International Power Co. Ltd.*): Thank you, Mr. Chairman and honourable senators. First, I would like to thank you for giving us this opportunity to appear before you. We appreciate this occasion to discuss with you our company's position and how it is affected by the White Paper proposals. Our operations, although not identical, are in many ways similar to those of other large international operations based in Canada, such as for example Brascan, Massey-Ferguson, Alcan, to name a few.

The Canadian International Power Co. Ltd. brief has been circulated to you and all I propose to do at this time is to actually introduce Canadian International Power Co. and give the highlights of its operations and how it will be affected by the White Paper, if the contents of the White Paper become legislation.

C.I. Power is a publicly held corporation. Its shares are listed on the Montreal and American stock exchanges. Through subsidiaries and sub-subsidiaries it operates electric utilities in Barbados, Bolivia, El Salvador and Venezuela. In Mexico, it operates a toy and games factory and a plastics factory. It also has investments in other industrial ventures. In Venezuela, it has diversified through joint ventures into hardware manufacture, electronic data processing services and real estate.

The total book value of the company's assets is now approximately \$210 million and its consolidated net income for 1969 was approximately \$13.5 million. The company is a Canadian taxable corporation and it has

approximately 3,000 Canadian shareholders and approximately 830 United States shareholders. The voting ownership is 61 per cent U.S. and 38 per cent Canadian. The largest single shareholder is The United Corporation of New York, with 47 per cent of the voting shares of C.I. Power.

The operations of the company were started in International Power Co. Ltd. and its subsidiaries. These were formed in 1925 under the Canadian tax rules that permitted the attraction of capital investments and the operation of its subsidiaries from Canada.

This group of companies was formed by Canadians and at that time was practically all Canadian owned.

After the death in 1955 of the principal shareholder of that group of companies, substantial U.S. ownership of the shares of the company came into the picture, with The United Corporation acquiring the major block of the stock. At the end of 1956, C.I. Power was incorporated to permit a more effective and more flexible operation. In other words, C.I. Power Co. could continue its foreign operations from Canada, and at the same time expand into Canadian investments.

I would like to point out that this is a long-range plan which first required building the organization into an operating unit that could effectively expand. It must be remembered that International Power group was part of a much larger group with operations in Canada as well as abroad.

The International section of the proposals creates problems for C.I. Power which will very materially affect the future of the company and the investment planning of its shareholders.

C.I. Power and its predecessor, International Power, as Canadian companies, made investments in anticipation of the continuance of the equitable tax treatment that has always been granted to Canadian enterprises operating outside Canada. The collective impact of the proposals is such that the value of these investments would be very substantially reduced and the ability of our organization to continue serving the expanding needs of its customers, while remaining in Canada, would be substantially impaired. An increase in Canadian taxation to operations in developing countries is tantamount to asking these developing countries to pay Canadian taxes or be taxed at Canadian tax levels, which they can ill afford to do.

The purchase of C.I. Power shares by U.S. interests in 1956 resulted in Canada getting the benefit from the accumulated earnings derived from a foreign investment. In addition, since 1956, C.I. Power has paid out to its shareholders over \$40 million in cash dividends. Of this, approximately \$27 million was paid to Canadian shareholders and taxed at their progressive tax rates. The balance of the dividends paid withholding taxes of \$1,700,000. During the last seven years, C.I. Power made purchases in Canada of goods totalling \$6.5 million. It paid \$4,600,000 to Canadian concerns for engineering services and \$3,400,000 in salaries to its employees in Canada. It has expended approximately \$2,700,000 for insurance, legal, accounting and other expenses. These expenditures in Canada represent moneys generated by C.I. Power's subsidiary companies in their respective countries of operation. They represent a direct contribution to Canada's balance of payments. In this period there were no additional capital investments required to be drawn from Canada. In addition to these direct cash benefits, this company does leave a door open to opportunities that will come with development in Latin America and the Caribbean. If Canada is to participate in the benefits of development, we feel it must play a part and take advantage of opportunities that are bound to occur as that area develops. I would like to bring to your attention—I know that some of you already know this—that 57 of the leading Canadian companies believe in the opportunities and resulting benefits of the development of Latin America and the Caribbean. From this belief, they have formed the Canadian Association for Latin America to encourage and promote Canadian business participation with the countries in that area.

C.I. Power's operations are entirely in developing nations. In Canada, it has recently formed within wholly-owned subsidiary, C.I. Power Services Limited, its own engineering section to do engineering for its present operating companies, as well as to evaluate and undertake new business.

The International section of the proposals for tax reform states:

...the Canadian tax treatment of the foreign income of Canadians does not seek to discourage Canadians from investing or carrying on business abroad.

Since the impact of the proposals of the operation does impair and discourage invest-

ing and carrying on business abroad and I refer particularly to developing nations, we are concerned with the following proposals which affect C.I. Power's operations. The White Paper proposes to tax dividends received from a foreign subsidiary operating in a country with which there is no treaty. Such dividends are presently exempt under section 28 of the Income Tax Act. As an example, the countries where we operate, such as Venezuela, El Salvador, Mexico, Barbados and Bolivia, are all developing nations. They do not have tax treaties with Canada and all have lower corporate tax rates than Canada. The White Paper proposal would impose a tax burden on their dividends and thereby impair our ability to operate these properties out of Canada.

The White Paper also proposes to tax the entire income of a foreign branch operation while taxing only actual dividends received from a foreign subsidiary; such foreign branch income is presently exempt under section 71 of the Income Tax Act.

Our Bolivian Power Company operates as a branch in Bolivia. It is not practical to change this status. The White Paper proposal would impose a tax burden on the Bolivian operation which would make it impossible for us to continue its operations.

The White Paper also proposes to tax the entire gains on the sale of shares of foreign corporations but only 50 per cent of the gain on the sale of widely-held Canadian corporations; no part of either type of gain is presently taxed.

Since all of C.I. Power's subsidiaries are closely-held or foreign corporations, gains would be taxed at the high rate further impairing ability to operate out of Canada.

The White Paper proposes to tax periodically appreciation in value of shares of widely-held Canadian corporations even if such gain has not been realized and even if there are no funds with which to pay such tax. For example, to pay the tax, The United Corporation, our largest shareholder, might have to dispose of its shares, thereby depressing the market and again impairing our ability to operate out of Canada.

The White Paper proposes to tax to the parent the passive income of a foreign subsidiary even if not remitted and without regard to the circumstance under which the passive income arose; no undistributed income of a subsidiary is presently taxed to its parent.

C.I. Power subsidiaries, as electric utilities, must meet their obligations to supply electric service. They frequently require to set aside funds to be readily available to expand the service facilities when required.

The proposals add to the circumstances under which foreign source income is subjected to Canadian tax while ignoring source country restrictions on use and repatriation of such income.

Due to exchange and other governmental controls in some of those countries, it may at times be impossible for income to be remitted. Presently, no profits may be repatriated from Bolivia.

The proposals do not distinguish adequately between direct investment in developing countries and other types and areas of investment.

The White Paper proposes to grant a larger dividend credit to shareholders of Canadian corporations operating solely in Canada than to shareholders of Canadian corporations operating outside Canada, either directly or through foreign subsidiaries; both categories of shareholders presently are given the same credit under section 38. There is a relatively free flow of direct Canadian investments to developed nations such as the United States. The flow of direct Canadian investments to developing nations is limited. The proposals would further discourage direct Canadian investment to developing nations.

I have summarized the problems as affected by the White Paper.

I would like to add that in our brief we did offer alternatives to the foregoing proposals, wherever it was possible.

With this summary, I would like to introduce first Mr. William M. Hickey, our chairman and chief executive officer, who is also president of The United Corporation of New York. On his right is Mr. E. H. Campbell, our vice-president of finance. On his right is Mr. A. B. Creagh, legal counsel and secretary to the company. On his right is Mr. H. P. Crevier, his assistant.

The Acting Chairman: Thank you, Mr. Kazakoff.

Mr. Kazakoff: As I said earlier, The United Corporation is the major shareholder of Canadian International Power Company. Before inviting questions, I believe Mr. Hickey would like to address you for a few minutes regarding The United Corporation's position in this connection.

Mr. W. M. Hickey, Chairman, Canadian International Power Co. Ltd., President, United Corporation of New York: Mr. Chairman and honourable senators, thank you very much for the opportunity to appear before you. I agree, and The United Corporation agrees, with the statement of Mr. Kazakoff and the brief which has been filed by Canadian International Power Corporation Limited. We have not filed a separate brief, because it would simply be repetitious to do so.

May I say that The United Corporation is a rather large investment company in the United States that has had a long experience particularly in public utility financing and operation and so forth.

We recognize of course that all countries need to review their tax structures from time to time, their need for revenues, and so forth, and to eliminate inequities and loopholes that should be eliminated.

The control of Canadian International Power Company was acquired in 1956 by the United Corporation and a group of investment companies in the United States. At that time \$25 million passed from the United States to Canada in payment for approximately 51 per cent of the shares of, at that time, International Power Company Limited. That money in turn, through succession duties, went into the treasury of the Dominion of Canada.

The Canadian International Power Company system, even though its control was acquired by the United States, was left in Canada and the intention at that time, and since, has been that it should remain permanently in Canada, because of the high regard that investors have for the stability and fairness of Canada to investors.

However, there are several provisions of the White Paper that would be very harmful to Canadian International Power and hence to the investors, both Canadian and in the United States, in the shares of Canadian International Power. If the legislation were enacted as it is proposed in the White Paper, the stockholders of Canadian International Power, I feel, could not continue to operate it in Canada.

Now, the Finance Minister of Canada and his staff have been very courteous to us and very understanding of our special problems and I might say some of these problems would be very difficult for anyone to anticipate.

For example, in Bolivia we have what is called tax sparing. Bolivia is a highly underdeveloped country, has a great potential, but at the present time is really quite poor and they have allowed the Bolivian Power Company to operate without paying direct taxes on its operation in order to keep electric rates in Bolivia low, and these electric rates have been extremely low and the service has been good and that has reflected credit on the Canadian company that has operated there; but the White Paper takes no account of that tax sparing and also would impose taxes on the operation of Bolivian Power as a branch.

It is actually a Nova Scotian corporation, going back 45 or 50 years and if this legislation were enacted, why Bolivia would simply impose the taxes because they would say "Why should we not get the benefit of these taxes if Canada, a rich country, is going to get them?"

The whole operation would be so badly upset that I do not see how it could continue.

Now, I would like to add that I believe that Canadian International Power has been a complete plus to Canada, economically and from an intangible point of view. Mr. Kazakoff has quoted the many millions of dollars that have been spent for services, engineering services, legal services, insurance services, banking services, and manufacturing products and so forth in Canada that were the company not in Canada probably would not have been spent in Canada. In addition, of course, there are very substantial salaries and wages paid in Canada which in turn are taxed.

Then, in addition to that, I think this creates a very valuable image in these Latin American countries for Canada. For example, in Venezuela, the companies there are very well operated. They are very highly regarded. They have the lowest electric rates and the finest services in Venezuela and it is thought of as a Canadian company, which it has been for some 45 years and most of the foreign personnel are Canadian and they are well thought of.

When the Canadian Commission for Industrial Development in Latin America for promotion of trade from Canada to Latin America comes to Venezuela, Canadians are already there and already well thought of so that from an intangible point of view this operation is very favourable to Canada, as well as from the actual tangible point of view of the amount of trade and income that it brings into Canada.

Many of these provisions of the White Paper are very well thought out to eliminate the inequities of tax havens, but these companies are not tax havens. These are actual legitimate operating companies and I think it is very necessary in any tax legislation to recognize that and permit these companies to continue, to operate as they have been in the past, because we are not evading any taxes, not operating as tax havens.

I think that pretty well summarizes it.

The Acting Chairman: Thank you, Mr. Hickey.

Mr. Hickey: I will answer any questions.

Senator Beaubien: Mr. Hickey, if the White Paper were to be implemented as it is, what would you have to do? Would you have to move the headquarters of your company?

Mr. Hickey: I sincerely say we would be forced to develop plans to either gradually or very quickly move the company from Canada.

Senator Beaubien: Would you be better off in the United States?

Mr. Hickey: Yes. You see, think of it. In Venezuela, for example, there are substantial direct taxes on operation. In addition to that there are withholding taxes on any dividends. If the dividends were taxed at the regular rate in Canada, that would be an additional tax and then the dividends in turn would go to the United States, and there is a withholding tax in Canada so that by the time you get through you would have no earnings left.

Senator Beaubien: Supposing you were operating in the United States instead of Canada, what tax would there be imposed by the United States? What are the laws there? What are the laws of the United States now compared with the laws of Canada for the same problem?

Mr. Hickey: I could not answer that specifically. There are taxes, of course, but you would have eliminated the layer of taxes

Senator Benidickson: The second withholding tax.

Mr. Hickey: Yes.

Senator Beaubien: You would eliminate it?

Mr. Hickey: Yes. You eliminate taxes coming into Canada under the White Paper and then the withholding taxes go back to the

United States under the White Paper. Does that answer your question?

Senator Burchill: You spoke of the minister and his staff...

Mr. Hickey: Yes.

Senator Burchill: ...being very sympathetic to your problem particularly with respect to Bolivia, about which you spoke.

Mr. Hickey: Yes.

Senator Burchill: But you did not go on to say what happened. You said he was sympathetic.

Mr. Hickey: Yes.

Senator Burchill: You did not tell us what the result of the interview was, if you had an interview.

Mr. Hickey: Well, I would say they were very courteous and very understanding of our particular problems and they left us with the hope that any tax legislation would be sympathetic to these problems and would not cause disaster to us and would not force us out of Canada.

Senator Burchill: So you are optimistic.

Mr. Hickey: Well, they were very courteous and understanding.

The Acting Chairman: Let us put it this way: you at least give us credit for good manners, but you are not sure whether the bite has gone or not.

Mr. Hickey: Yes, we are concerned.

The Acting Chairman: May I summarize. I think it may be helpful to honourable senators as we go along. I think from you, Mr. Kazakoff and Mr. Hickey, we have a clear picture and we have also had the benefit, of course, of prior briefs dealing with the whole subject matter.

As I see it, you face four basic problems. One: the problem of dividend income coming in under the White Paper. Two: the problem of foreign branches being operated by either the parent company now before us or any of its Canadian subsidiaries. Three: the problem of capital gains. Four: the question of credits in the event of dividends being paid out.

Now, without limiting whatever honourable senators may have to direct to you by way of questions and answer, we are pretty clear on the problem, I think, speaking for myself, of

inequities that would result from being taxed by way of passive income on dividends and also foreign branches, which you explained, but I would like to develop a little bit with you this problem of capital gains.

Mr. Hickey: Yes.

The Acting Chairman: Maybe before I do that, I should say that I think that we are pretty clear on the issue of closely-held or widely-held corporations and, shall we say, the inequity that might result from the implementation of different rules, but I would like to direct myself to the problem of capital gains.

There seems to be a feeling that we should have a capital gains tax in Canada and, if so, Canadian taxpayers will be subject to a capital gains tax. Would you guide us a bit on this point as to why you think we should give special treatment to Canadian companies in respect of capital gains resulting from sales of foreign shares or foreign assets, because I think Mr. Kazakoff has included that as one of the items that are troublesome to you. I am wondering why, since you are a Canadian company, we would be justified in concluding and drawing a distinction between a capital gains tax applicable to Canadians in respect of acquisition and sale of capital assets as distinct from the acquisition and sale of non-Canadian capital assets.

Mr. A. B. Creaghan, Secretary and Legal Counsel, Canadian International Power Co. Ltd.: We feel rather strongly that insofar as most of our companies would be considered, as we read the White Paper, as closely-held companies the incorporation locally is a vehicle in which we are operating rather than as a direct branch, and therefore they should be treated, if the White Paper is legislated, as a widely-held corporation. In other words, to have half the gain. While we did not stress it in our brief, most countries, as we understand it, have exempted controlled subsidiaries from capital gains.

The Acting Chairman: But that would be by treaty. Let me develop this point a little more. Suppose we eliminate the integration and suppose we did away—which would be a corollary of that—with the distinction between closely-held and widely-held corporations, and suppose we isolated the application of capital gains tax in a separate category as a part of our law, somewhat similar to what you have in the United States, are you

still taking the position that in view of the fact that you operate in underdeveloped countries with which we do not have tax treaties such as we have with other countries, which exempt capital gains, and on the assumption we will be able to work out those treaties or amendments to those treaties with those countries, are you still taking the position that because you are investing in non-tax treaty countries, you should be exempted from capital gains tax which we may impose in this country?

Mr. Kazakoff: I am going to ask Alan Creaghan to talk about the law, but in general terms the economics of the operation is as follows; we are operating in developing nations and we are particularly in the electrical utilities field, and we have either a financing of operations out of earnings, or if there ever becomes a demand for an expanding, we have to raise capital. We have been able to do this under the present tax laws in Canada quite effectively, but if there is an additional tax burden placed upon us, since all of our earnings come from the developing nations, that tax burden is really coming out of the earnings of those nations.

It is actually asking those countries to pay higher taxes than they are doing now. Therefore it would impair our ability to operate out of Canada, and we would have to seek means to compete with either how they could do it themselves, or how others might do it, or how we might do it out of another place.

The Acting Chairman: I am still back to the point—and not by way of cross-examination, but by way of seeking clarification as we are beginning to crystallize our thinking...

Mr. Creaghan: One other point...

The Acting Chairman: May I develop this?

Mr. Creaghan: Yes.

The Acting Chairman: We are assuming the elimination of the integration system and we are assuming further that you retain your relief in respect of dividend income under section 28 of the Act and we are assuming you get your relief under section 71 of the Act with respect to foreign branches. We are assuming that there is no distinction between closely-held and widely-held corporations, which is a corollary of integration. Let us assume that we have reached that point and that now this committee in its wisdom and bowing, shall we say, to public opinion, or

bowing to X, Y, Z, or of its own merits comes to the conclusion that we should have a capital gains tax in Canada and that a special rate shall be applied, because we have eliminated the distinction between public and closely-held corporations. Are you still taking the position because you deal with under-developed countries which are usually non-treaty countries, that you should be exempted from the proposed capital gains tax in respect of acquisition and sale of non-Canadian capital assets, meaning shares in a Bolivian company or in a Venezuelan company and all that sort of thing, because there will be no tax treaty relief?

Mr. Creaghan: We have one basic problem. Our thought is that if we sell shares which have a gain in Venezuela, we are subject to Venezuelan tax at whatever the corporate rate might be on our earnings in Venezuela.

The Acting Chairman: But it is a corollary that today in Canada, if we had a capital gains tax, and you bought and sold shares in a Canadian company and you were subject to tax like everybody else because you are a Canadian company, are you saying in respect of non-Canadian acquisitions and dispositions that you should not be taxed because you are operating in a non-tax treaty area?

Mr. E. H. Campbell, Vice-President, Finance, Canadian International Power Co. Ltd.: Principally I think the reason is that we are paying tax in those foreign jurisdictions on precisely that same capital gain. It is in fact double taxation.

The Acting Chairman: I am not critical of the position that you are taking. I simply want to know that if that is the position you are taking.

Senator Aird: Would some part of your thinking be that there is a high risk factor involved? Also, these are non-Canadian assets and they are in developing areas, and I think the philosophy behind the imposition or non-imposition of capital gains tax in relation to the area you are working in—I think this is part of your argument, if I may respectfully so suggest.

Mr. Campbell: That applies not only to capital gains but to all our operations.

The Acting Chairman: I have already made the point, Senator Aird, and I hope that it is clear that in putting these questions, all I am

trying to do is to crystallize your formulation and to understand the parts that were not clear to me.

Senator Carter: I am not quite clear if the witness stated that there is a capital gains tax now in Bolivia and Venezuela. Is there a capital gains tax in the countries in which you are operating?

Mr. Campbell: Not a capital gains tax, but a tax at the ordinary rate—the present income tax rate.

Mr. Kazakoff: But in effect it is a capital gains tax.

Senator Carter: But it is integrated into income and taxed as income.

Mr. Kazakoff: That is right.

Senator Benidickson: But this would be corporate income. Would it not be a flat corporation tax in those countries as it is here? It is not like the personal tax which is progressive.

Mr. Kazakoff: It is progressive in Venezuela.

Senator Benidickson: That is to say it is progressive for corporations and it depends on the amount of income?

Mr. Campbell: At the highest rate of income, it is 50 per cent.

Senator Hays: Mr. Chairman, may I ask a question not related to capital gains? You say that if the White Paper proposals are implemented you would have to withdraw from Canada as far as the parent company is concerned. What are the mechanics of withdrawal? How would you go about it? Would you sell in Canada or how would you operate?

Mr. Hickey: We would have to develop that, and it would be quite a substantial, complicated process, even directly or over a period of years. Just how we would do it, I could not say at this point because we have not developed it yet because, as the Chairman says, we have been quite optimistic that the Minister of Finance and his staff will understand our particular problems.

Senator Hays: Supposing they are not, you must have given that some thought if you are going to withdraw.

Mr. Hickey: It would be a very substantial operation, probably something that would

have to take place over a period of years, and we would have to consider all the financial, investment and tax matters connected with it.

Senator Hays: Would you make a complete withdrawal in Canada and sell your interests in Canada?

Mr. Hickey: I think we would have to, yes, because the burden would be so great.

Senator Hays: So these would be en bloc?

Mr. Hickey: Yes.

Senator Hollett: That would affect how many of your employees in Canada?

Mr. Kazakoff: We have something over 40 employees in Canada.

Senator Hays: They could be transferred, if somebody else took over.

Senator Hollett: How many employees was it?

Mr. Kazakoff: We have 40 employees in Canada. We have over 2,000 employees altogether.

Senator Aird: Could I ask a supplementary question to Senator Hays? As I understand the evidence, in 1956 you paid \$25 million for 51 per cent. Over a 15-year period what is the market value of that \$25 million today?

Mr. Hickey: Actually, the \$25 million was paid by a group of investment companies of which the United Corporation was the largest, roughly half of it. Since then, from time to time we have bought out the others, generally at a profit to the other investment companies. So, today we own approximately 51 per cent of the common stock and 47 per cent of the floating stock. The market value of what we hold today is something of the order of \$35 million.

Senator Aird: Do you consolidate CIP on your balance sheet?

Mr. Hickey: No, we do not. We treat it as an investment.

Senator Aird: Could I ask you why not?

Mr. Hickey: Because we are an investment company and not an operating company, and we have always treated everything that we hold as investments rather than consolidating it.

Senator Hays: Mr. Hickey, assuming the White Paper proposals are implemented, what

country would you then reinvest that money in? What country would be the most favourable, from your point of view?

Mr. Hickey: I assume it would probably be the United States, because that is where the largest amount of the stock is held. Some two-thirds of the stock is held in the United States, and that would probably be the most favourable place over-all to have the operation.

Senator Hays: Are there any other countries you feel that you should withdraw from at this time because of tax problems?

Mr. Hickey: A large part of the operation would probably continue in Venezuela, and Venezuela is quite favourable from the tax point of view.

Senator Hays: Is it much more favourable than Canada?

Mr. Hickey: Yes.

Senator Hays: Is this true of most of your widely-held investments, if the White Paper proposals are implemented?

Mr. Hickey: Would you repeat that question?

Senator Hays: Would Canada's position then deteriorate whereas your holdings in other countries would be more desirable?

Mr. Hickey: Yes.

Senator Hays: In every other country you invest in?

Mr. Hickey: Well, I will not say every country, but certainly Venezuela would be much more favourable to invest and operate in than Canada.

Senator Hays: What other countries do you operate in?

Mr. Hickey: Well, we operate in Mexico,...

Senator Hays: It would be more desirable?

Mr. Hickey: Yes, I would say that the way things are going in Mexico it would be more desirable to be in Mexico because they have been coming along fine and they are doing very well.

Senator Hays: What about Bolivia?

Mr. Hickey: Bolivia is a bit on the unstable side politically, and I do not think we would consider it.

Senator Hays: So, it would be Venezuela, Mexico...

Mr. Hickey: Yes.

Senator Hays: Any other countries?

Mr. Hickey: El Salvador is a rather small country and would not be a proper country to operate in because it is relatively small. Barbados is, of course, quite small too.

Senator Hays: But even then Canada would not be competing as far as your investments are concerned in foreign countries?

Mr. Hickey: No, I think that if all these provisions of the White Paper came in it would be virtually impossible for anyone to operate in Canada.

Senator Hays: You are saying categorically that tax-wise Canada would be the last country to operate in of all the countries you operate in?

Mr. Hickey: Yes. I think that tax-wise that is true. As much as I am reluctant to say it, Canada would be very unfavourable for an international company to operate in, from a tax point of view.

Senator Hays: If that happened, I suppose you would not even spend your holidays here!

Mr. Hickey: No, I think...

Senator Hays: I am being a little facetious.

Mr. Hickey: ...I would still spend my holidays here.

Senator Desruisseaux: Mr. Chairman, would it not be helpful if we had the annual statement filed, because of the subsidiaries and the operation of these subsidiaries?

The Acting Chairman: Yes, I think it would be helpful. Would you suggest that the last annual statement be filed to form part of the record?

Senator Desruisseaux: Yes.

The Acting Chairman: What is your fiscal year, the calendar year?

Mr. Kazakoff: Yes, the calendar year.

The Acting Chairman: Would you be good enough to file it as part of the record?

Mr. Kazakoff: Yes, Mr. Chairman.

Senator Desruisseaux: I note on page 7 of the brief you speak of the development of

plans for helping other countries and their contribution. In the last paragraph on page 7 there is the development of the Lester B. Pearson philosophy and plans that were set forth in "Partners in Development". On page 8 I note the feelings of the company about the attitude of the Canadians, and in the third paragraph on page 8 you say:

Canada's contribution to the economic growth of the developing countries would be jeopardized if the discrimination implicit in the tax proposals against foreign-source income becomes legislation. The "White Paper" does not adequately distinguish between capital transfers to the developing nations and other parts of the world. The elimination of barriers to the transfer of capital and technology from the developed nations to the developing nations was strongly recommended by the Pearson Report. Canadian multi-national firms are important and useful conduits for such transfers.

Would you please elaborate upon that?

Mr. Creaghan: Mr. Pearson states in his report that there is need not only for aid from the developed to the developing nations, but that international corporations must play their part in bringing capital to these nations.

We entirely agree with that report. If the White Paper proposals were implemented, Canadian corporations could not play their part, but would be hindered.

Mr. Kazakoff: In other words, Canadian investors would probably hesitate to invest in a company such as Canadian International Power Company Limited if the White Paper were implemented. They would turn their investments elsewhere and Canadian citizens would be less able to play their part in the developing nations.

Senator Desruisseaux: They might have to do it themselves.

Mr. Kazakoff: The point is that some of us feel that there are opportunities to be missed in development. It is not all benevolent; it is a two-way street.

Senator Benidickson: We have had, of course, other international, multi-national corporations appear before us. However, C.I. Power have put the international case as clearly as anyone to date.

I am impressed by the fact that they emphasize that there is nothing in their oper-

ations internationally that is along the lines of the tax haven.

It has been suggested that the drafters of the White Paper may have been emphasizing the desire to eliminate loopholes and tax havens internationally with respect to our tax system. We will have a subcommittee in the first instance studying these briefs and presenting recommendations to the full committee. In due course the recommendations will go on to the minister.

In my opinion this subcommittee should pay particular attention to the points on page 6 of this brief, where it is stated that a very radical change takes place in relation to your operation. It is pointed out that such dividends are presently exempt under section 28 (d). The next paragraph says that such foreign branch income is presently exempt under section 71. The brief goes on to say that no part of either type of gain is presently taxed. Another paragraph states that no undistributed income of a subsidiary is presently taxed to its parent. In the final paragraph of your summary it is stated that both categories of shareholders presently are given the same credit under section 38.

The radical change in dollars and cents affecting taxes is clearly presented in this brief. You have seen the Minister of Finance and felt that he was sympathetic to the dollars and cents effect upon you as an international company.

I am sure that these representations presented so succinctly here for an international company will receive the sympathetic interest of our subcommittee in the first instance.

Senator Cook: I note that some of these companies were formed before we had the income tax. One was formed in 1900 and another in 1905, so there could not be much tax haven philosophy behind their operation.

Mr. Kazakoff: No, and none exists today.

Senator Carter: Is it fair to imply from your brief that if the developing countries were treaty countries it would largely take care of your problems? We do not have tax treaties with these countries and you say that the possibility is rather remote.

If by law it were deemed that the developing countries were to be tax treaty countries would it take care of your problems?

Mr. Campbell: Substantially, but it would still leave out our companies formed under

section 71, which are Canadian foreign business corporations which have tax exemption and operate abroad as branches but will be taxed at the total income tax level of those countries.

One of these countries is Bolivia, which practices this tax theory. Therefore it would be a very substantial increase in Canadian taxes.

The Acting Chairman: Senator Carter, section 28 would not help you on that basis, even if it were a tax free country.

Mr. Campbell: It would be of some assistance, but not entirely.

Senator Burchill: Have you made a comparative statement on the basis of your 1969 earnings as to how you would be affected financially if the present proposals of the White Paper were put into effect?

Mr. Kazakoff: Yes, we have made it on the basis of our 1970 estimate.

Senator Burchill: What difference would it make in your income?

Mr. Kazakoff: Two and one-quarter million dollars.

Senator Burchill: You would be down \$2½ million?

The Acting Chairman: Would that be in profits or increased taxation?

Mr. Kazakoff: It would be increased taxation.

The Acting Chairman: It would increase taxation by \$2½ million.

Senator Benidickson: You are not contemplating any dispositions in 1970 which would make additional capital gains?

The Acting Chairman: And that \$2½ million would be payable to the Canadian Government?

Mr. Campbell: That is correct. These are additional taxes under the White Paper.

Mr. Kazakoff: That would be \$2½ million in \$13½ million.

Senator Hollett: What was your income last year?

Mr. Kazakoff: Net income was \$13½ million.

Mr. Hickey: That is consolidated net income. The actual income coming into Canada was very much less than that.

Mr. Campbell: It was about \$11 million.

Mr. Hickey: No. The corporate income coming into Canada was only a minor fraction of that amount, because so much has to be re-invested.

Senator Benidickson: The White Paper proposals would involve an imposition of tax by Canada on income that has not arrived here.

Mr. Hickey: That is right. These figures also would be illusory in the sense that if the White Paper proposals were ever applied to Bolivia they would immediately charge taxes in order that Bolivia, a developing country, would benefit rather than Canada, a rich count

Senator Cook: The only income tax that you pay now is the withholding tax on dividends in Canada, which you say amounted in 1956 to \$1,700,000.

Mr. Hickey: Yes. However, we make very substantial payments for professional services, wages, salaries, and so forth, which are in turn taxed in Canada.

Senator Benidickson: Yes, Mr. Kazakoff gave us some interesting figures about your expenditures in Canada for professional services, wages, supplies and so on. I did not hear the term of years to which those figures applied.

Mr. Kazakoff: They apply to the last seven years. The total amount over the last seven years was \$17,200,000.

Senator Isnor: Are there different branches made up separately so far as returns are concerned? For instance, Bolivian Power operates out of Nova Scotia. Where is their office in Nova Scotia?

Mr. Creaghan: We simply have a registered office in Nova Scotia. The head office of the company is in Montreal.

Senator Isnor: It does not mean there is any operation there?

Mr. Creaghan: There is no operation in Nova Scotia.

Senator Isnor: You do not issue individual financial statements each year?

Mr. Creaghan: Yes.

Senator Isnor: You do?

Mr. Kazakoff: Yes.

Senator Isnor: Yes say you do?

Mr. Creaghan: Yes, we do.

Mr. Kazakoff: The annual statement of Bolivian Power Company is issued every year.

Senator Isnor: They are made up separately, are they?

Mr. Creaghan: That is correct.

Mr. Campbell: And it is filed in Nova Scotia.

The Acting Chairman: Gentlemen, let us tidy up the record a bit. We have covered the four basic points you have made, but if I understand it these are inferences from your basic objection to the White Paper, which contemplates the integration system. I think we can take it that as a corporation you are against the proposed integration system covered by the White Paper.

Mr. Creaghan: That is correct.

The Acting Chairman: As being very damaging to you.

Mr. Creaghan: Yes, sir.

The Acting Chairman: That would be point No. 1. Am I right in saying that point 2 is that if an integration system were implemented you are against this whole concept of division in treatment between closely held companies and widely held companies?

Mr. Creaghan: That is correct, sir.

The Acting Chairman: If we were to have an integration system?

Mr. Creaghan: That is correct, sir.

The Acting Chairman: That would be point 2. I understand you further to say that if we were to have a capital gains tax in Canada, in view of the special nature of your operations in non-tax treaty countries—because I would imagine that is the only way to distinguish underdeveloped countries; there is no definition for an underdeveloped country.

Mr. Creaghan: That is correct, sir.

The Acting Chairman: You feel that special treatment must be considered for capital

gains resulting from investments in those corporations for the reasons already mentioned?

Mr. Creaghan: Yes, sir.

The Acting Chairman: Is that a fair recapitulation?

Mr. Creaghan: That is a fair way of saying it, sir.

Mr. Campbell: Could I elaborate on the question of capital gains? It is the policy of the company to spread part of its ownership in the local subsidiaries, in the subsidiaries outside Canada, so that local shareholders, investors, have an interest in these companies. Although the company is well satisfied with its investment, it is putting out these shares for local investors to buy so that local people will take an interest in that enterprise.

The Acting Chairman: I am familiar with that background, because I used to sit on the Brazilian board.

Mr. Campbell: You could have a capital gains tax there, but it is really with this idea, not with the idea of making a profit.

The Acting Chairman: I think that is a very important point. In other words, because of public policy in those countries you end up by disposition of your assets, of certain of your shares, which otherwise you would not do.

Mr. Campbell: That is right.

The Acting Chairman: Were it not for the necessity of meeting local sentiment.

Mr. Campbell: That is right.

The Acting Chairman: Would you like to develop any further points that have not yet been clarified or discussed?

Mr. Creaghan: There is just one point on Bolivian Power. The question might arise: why could you not dissolve the Nova Scotia company and form a Bolivian company, as some other corporations have done? We investigated this, long before the Carter Commission even came up, and we found it virtually impossible to do this in Bolivia. It would mean indemnity payments to all our employees; we would have to re-negotiate all existing concession contracts; there would be a very substantial property transfer tax, and it would be virtually impossible for us to do this. I would also like to put on the record that our visit to the Minister of Finance took place before the White Paper was issued.

Senator Burchill: When was the Nova Scotia Bolivian company set up? When was incorporated?

Mr. Creaghan: In 1926.

Senator Molson: Do you mean that there is no Bolivian company a subsidiary of the Nova Scotia company?

Mr. Creaghan: No.

Senator Molson: The operating company is a Nova Scotia company?

Mr. Creaghan: Registered in Bolivia.

Senator Molson: So there is no incorporation in Bolivia for the operation?

Mr. Creaghan: No.

Senator Molson: Is this true of the other countries?

Mr. Kazakoff: The others are all subsidiaries.

Senator Molson: All subsidiaries?

Mr. Kazakoff: All subsidiaries.

Senator Molson: In the country?

Mr. Kazakoff: In the country.

The Acting Chairman: Reference was made to the Bolivian company because there is tax relief under section 71 of the present Income Tax Act; that is why we pointed out previously that for this company and its associated companies is that there is a problem of exemption under section 28, which would be lost under integration; taxation because relief would be lost under section 71; shareholder discrimination because of the distinction between closely held and widely held corporations; and lastly the problem resulting from capital gains because of their activities in non-tax countries. If you tidy it all up, the problems result mainly from the whole conception of integration, whereas section 28 and 71 will presumably remain if integration were abandoned; publicly held and privately held corporations would wither on the vine, and then we would be left only with a special problem, if we had a capital gains tax, of the treatment of a company such as this carrying on in non-treaty countries or underdeveloped countries. I think that pretty much crystallizes the position?

Mr. Kazakoff: Yes, sir.

The Acting Chairman: Now, we want to be absolutely sure you have covered everything you wish to say.

Mr. Campbell: There is one other point that we might develop, and that is the question of roll-over in the case of a forced sale of property, as in the case of the Monterey company. We have an electric utility and a gas utility in the City of Monterey, and through local government policy we are obliged to sell this company. We took securities which were payable over a period of 15 years at a nominal rate of interest like 6.5 per cent per annum. This was because the price that we got was not as high as it might have been, and also by virtue of the fact that we were not to be taxed locally. We also have the obligation to re-invest in the country.

As foreseen by the proposals in paragraph 3.44 of the White Paper there is a roll-over provision in respect to, it seems, Canadian operations; you have to re-invest in some similar operation within one year. In our case, as you will see, it would be virtually impossible. We have 15 years only to receive payment. Secondly, it would be impossible to invest in a similar operation such as a utility; the government has taken over all utility services in Mexico, so there should be some latitude there. There is some question whether the White Paper proposals extend this roll-over provision to the international sector. This is, should there be a capital gains tax.

The Acting Chairman: I think it is very important to get that clearly on the record. You might be subject to capital gains tax, but you really have not got the capital resulting from the so-called capital gain, not only because you get a certain type of security which only unfolds itself in value through the years, but also you are forced to use part of the capital gain for internal investment, whether you like it or not.

Mr. Campbell: That is correct.

The Acting Chairman: Therefore you feel that is another special factor applicable to your particular situation.

Mr. Campbell: That is right.

The Acting Chairman: These are samples, honourable senators, of the problems that arise when you begin to introduce a capital gains tax. It sounds simple, but it is not quite so simple when you get down to detailed analysis.

Are there any further questions? ... Gentlemen, have you any further points you would like to make?...

We are grateful to you for presenting your case to us, which we think will help us.

Mr. Kazakoff: Thank you very much, Mr. Chairman and honourable senators, for listening to us.

The Acting Chairman: Honourable senators, the next group this morning represents The Canadian Mutual Funds Association. We have with us Mr. J. M. Godfrey, Q.C., on my right, who is President of the Canadian Mutual Funds Association and President of the United Accumulative Funds Ltd., and who is, incidentally, one of our outstanding lawyers at the Canadian Bar. We have Mr. J. McAlduff, Vice-President of the Investors Group and Chairman of the Taxation Committee of The Canadian Mutual Funds Association. We also have Mr. Warren McEwan, who is not on the list, but who will rise and identify himself now. Then we have C. Grant, Q.C., Counsel for The Mutual Funds Association and Mr. M. Bell, the Executive Director.

Gentlemen, you have seen how we proceed and you have heard the usual criss-cross of questioning. I take it that Mr. Godfrey will start.

Mr. J. M. Godfrey, Q.C., President, the Canadian Mutual Funds Association and President, United Accumulative Funds Ltd.: Mr. Chairman and honourable senators, first of all, I think I should explain who we represent. The Canadian Mutual Funds Association represents 90 per cent of the industry. As of December 31, 1969 it represented assets, invested mutual funds, of \$2,677,000,000 and it represented 744,000 different shareholders accounts.

As well as giving a very brief summary of the brief which we have presented, I should like in my opening remarks also to refer to meetings which we have had with officials of the Department of Finance who have been concerned with the White Paper. I think it would be fair to say that, with one specific exception, the general intention of the White Paper was to tax the shareholders of mutual funds on the profits made by the funds in the same way as if the shareholders owned the portfolio securities of the funds directly. This is a reasonable approach, because mutual fund shareholders cannot really expect to be in a better position from a tax point of view

than someone who directly directly invests in the securities of other public companies.

To accomplish this purpose, the White Paper provided that mutual funds would pay the taxes on their income and capital gains and the balance of the income and capital gains would be distributed to the shareholders, who, unless they were in a top tax bracket, would receive a tax credit which would result in a refund to them of a portion of the tax paid by the mutual fund.

While this would result in the shareholders receiving the dividends that flow through the mutual fund and capital gains on widely-held Canadian public corporations, subject to the same tax as if they the shareholders of the funds, had received these dividends or capital gains directly, unfortunately the shareholders of mutual funds would, under the White Paper proposals, pay from 12½% to 25% higher rate of tax on the interest income of the fund, on capital gains from closely-held corporations and on dividends and capital gains received from foreign corporations.

Furthermore, foreign shareholders of mutual funds would be taxed at rates varying from 43½% to 57½%, as compared to no tax, or at the most a withholding tax if the shareholder owned the underlying portfolio shares directly. This would mean, of course, that no foreign resident could invest in a Canadian mutual fund.

In my capacity as President of The Canadian Mutual Funds Association, I headed a committee from the industry, and we have had a series of meetings with officials from the Department of Finance. I think it is fair to say that they recognize the inequities under the present proposals in the White Paper, and they were not aware of the increasing investment by non-residents of Canada, particularly Europeans, in Canadian mutual funds.

We suggested to them, as we have suggested in our brief to you, that instead of taxing the mutual fund, with the shareholders being entitled to a tax credit, the mutual fund itself not be taxed by being given conduit or flow-through treatment for income and capital gains tax, similar to that in force in the United States. This would result in the mutual fund paying out to its shareholders each year practically all of its dividend income and its realized capital gains. The shareholders would then pay tax on these in exactly the same way as if they held the underlying portfolio securities directly.

There would be, both under the White Paper proposals and our alternative proposals, some real and very difficult technical complications in connection with the taxation of shareholders who redeem at a profit at a time when a mutual fund has a portion of its portfolio invested in foreign securities.

We considered many solutions to this problem, and eventually came to the conclusion, as is pointed out in our brief, that it was impossible to provide absolute equity to a redeeming mutual fund shareholder when a mutual fund portfolio consists of widely-held, as well as other securities. I would like to emphasize that this is equally true under the White Paper proposals, and our alternative proposal of conduit or flow-through treatment.

However, we have made a practical suggestion to solve this problem which we think gives reasonably equitable treatment, and this is discussed at pages 17 to 20 of our brief.

The other matter which we discussed in Part I of our brief, which deals with proposals contained in the White Paper which relate exclusively to mutual funds, is the problem of the valuation of mutual fund shares on valuation date.

To consider the extreme case, a mutual fund contractual plan sold with a front end load of 50 per cent on the day before V day would result in the planholder having to pay, if his shares increased in value, a capital gains tax on the 50% sales commission, even although the shares purchased would have to double in value before they were worth what he paid for them, that is, the shares purchased in the first year with the first payment. This is obviously inequitable, and the situation to such an extreme extent is peculiar to mutual fund shareholders.

We have made a suggestion at page 22 of our brief which solves this problem on an equitable basis.

To sum up, Part I of our brief asks for conduit or flow-through treatment for mutual fund shareholders, similar to the treatment given to them in the United States, with certain refinements, because unlike the United States, the White Paper proposals provide for two separate rates of capital gains tax.

Secondly, we are asking that mutual fund shares be valued on valuation day in the manner suggested in our brief.

In Part II of our brief we deal with three other matters which do not exclusively concern mutual fund shareholders but which are

of special concern to them, namely the imposition of the capital gains tax, the five-year revaluation proposal and the general discrimination in the White Paper against investment abroad.

Our association, and I believe we reflect views of the vast majority of our approximately 744,000 shareholders, is against the capital gains proposal, against the five-year revaluation and against the general discrimination against Canadian investment abroad. As the arguments against the five-year revaluation proposal are so clearly stated in the report made by the Minister of Finance on March 9, 1970, we did not consider it necessary to repeat those arguments in our brief.

There is one further point we would like to make, however, and that is if the five-year revaluation is rejected entirely it is not, in our view, necessary to substitute for it the taxation of accrued capital gains at death, because the combined rates of estate tax and succession duties in this country are sufficiently high, in our view, to provide adequate taxation of such gains at death.

In this connection, we rather differ from some of the other briefs which have been submitted, where it is suggested that estate and succession duties should be abolished in view of the capital gains tax. What we say is, keep estate and succession duties, but do not have a capital gains tax at death. In other words, estate and succession duties paid by children should be the same whether the money they inherited was the result of capital gains made before V day or after V day.

As far as the discouragement of foreign investment is concerned, we do not think it unreasonable, in view of the tax advantages enjoyed by pension and retirement savings plans, that the Government require a certain proportion of these pension funds and retirement savings plans to be invested in Canada. However, as far as the savings of investors outside these tax shelters, which will already have been taxed as income or capital gains, before they can be re-invested, we submit it is not reasonable for the Government to restrict the manner in which these funds are invested by imposing an additional tax burden if a portion of such savings is invested abroad.

Gentlemen, I think that briefly outlines what is contained in our brief, and I would be pleased to answer any questions you may care to ask.

The Acting Chairman: Thank you very much indeed. Would any of your associates like to supplement before we place any questions?

Mr. Godfrey: No.

The Acting Chairman: Honourable senators, are there any questions?

Senator Hays: Mr. Godfrey, on page 34 of your brief you oppose the imposition of a capital gains tax. You say, if it should be, it should be done, as far as rates are concerned, the same as in the United States. What do you suggest? Do you suggest that it be defined the same as in the United States for capital gains tax?

Mr. Godfrey: Do you mean as to whether there should be the same distinction between short-term and long-term?

Senator Hays: No. I am wondering how you would define capital gains for Canada or how should it be defined?

Mr. Godfrey: Well, if you are going to have a capital gains tax similar to the United States, then you are going to have to define it because under the present proposals, if it is closely-held it does not matter whether it is capital gains or earned income and if it is shares of a widely-held corporation, again it does not matter if you hold them for one day or five years under the definition.

Our association as an association has not taken a position on just how you would define capital gains, but I personally would say there should be some distinction between short-term and long-term.

Senator Hays: In your brief at page 34 you are suggesting the definition should be the same as in the United States.

Mr. Godfrey: Some similar type of definition, yes. They have arbitrarily taken a six-months' rate. I think in our brief we are saying that the rates should not be significantly different from what the United States are, rather than define the type and going into that question. We really did not go into the question of defining capital gains.

Senator Hays: In your opinion what would be a better tax as far as Canada is concerned?

Mr. Godfrey: We see it something like the United States.

Senator Hays: If there were no capital gains tax most of your problems would be solved.

Mr. Godfrey: Yes, if we go along. At the present time, as far as the mutual fund shareholders are concerned, a proportion of their profit in the past has consisted of capital gains which have been tax-free, and a proportion has consisted of income, a much smaller proportion.

They have taken a real risk, as has been shown in the last year and a half, as we all know. There is a risk investing in equities and so on, and because of that risk in the past we have not had a capital gains tax. We have tried to encourage risk-taking.

Senator Hays: But your people categorically oppose a capital gains tax.

Mr. Godfrey: That is right.

Senator Carter: In your brief you say your earnings accumulate and are re-invested again.

Mr. Godfrey: At the present time?

Senator Carter: Yes.

Mr. Godfrey: No. I think every mutual fund in Canada pays out its earnings at the end of the year. The strip all the undistributed income, but we sell mutual funds on the basis of long-term so we advise our shareholders that when they get the dividends to re-invest them in the mutual funds. They pay whatever tax is necessary but they re-invest it. We go to the extent of having automatic re-investment. When they buy the shares they sign a little slip of paper and say, "When you declare a dividend we want to automatically re-invest it," which shows our shareholders are interested in long-term and not in short-term dividend income.

Now, the mutual fund, of which I am the president, pays out about \$2½ million in dividends half-yearly or something like that, and all but about \$14,000 of that is automatically re-invested. It just never goes out. It is a bookkeeping entry. So out of that \$2½ million the shareholders only get \$14,000 in cash. The rest want to re-invest.

Senator Burchill: Your shareholders have the option?

Mr. Godfrey: Yes, they have, absolutely. If a dividend is declared, it goes out and they see they can re-invest it without any sales

commission, and so on. This is a good deal, and this is what they like.

Now, as to other mutual funds, one of the original mutual funds in Canada did not give an option of re-investing without any sales commission. The result is that the majority of their shareholders take the cash. They went into mutual funds for another reason, obviously for dividend income.

Senator Carter: Does your mutual association include a savings plan?

Mr. Godfrey: No. Investors Syndicate, who are here, have that as a separate part of their business. They have absolutely nothing to do with Canadian Mutual Funds Association. There are two of our members that are in both businesses, but they are completely separate and have nothing to do with each other. You are talking about savings certificates?

Senator Carter: Yes.

The Acting Chairman: In dealing with capital gains tax, some views have been expressed that we should not necessarily follow the rules currently applicable in the United States nor should we necessarily extend the capital gains tax, being a younger country, to all forms of capital gains. One thought has been expressed that, as a start, even though some taxpayers may benefit thereby, a capital gains tax should be applicable only to those who make profits resulting from the purchase and sale of securities, whether of listed or non-listed companies, and of profits made resulting from the purchase and sale of real estate, which includes land as well as buildings. In other words, we would substantially eliminate farms, private homes, objets d'arts, paintings and all that sort of thing on account of the cumbersomeness involved in dealing with the situation, and on the further assumption that people generally would not go into that sort of purchase merely for the sake of saving a capital gains tax.

Mr. Godfrey: Right.

The Acting Chairman: The question to you, because of the importance of your association, is: what do you think of the proposed introduction of a restricted capital gains tax along the lines I have just mentioned?

Mr. Godfrey: Yes. I would qualify the one on farms that that should apply only to family farms, if possible. For example, as opposed to large corporations—if somebody

has 100,000 acres it is really a corporation and I do not think they should necessarily be exempt. But family farms and certainly principal residences should be exempt. People to not buy those to make capital gains. They are exempt in the United States, I believe, after 1965.

You spoke of objets d'arts. From a practical point of view there are not enough people in Canada who can evaluate them. There is some kind of market for valuable Canadian paintings, but nobody can evaluate a great many of the European paintings and other objets d'arts. Nobody really has any idea at all.

The Acting Chairman: If we restricted capital gains tax in the manner I have indicated, would there be a rush of mutual funds to use its capital to buy items such as that or would you still be using your money to buy securities?

Mr. Godfrey: There are two problems that would apply to us as well as to the Government. One is liquidity and the other is valuation. And anybody who wants an objet d'art has the same problem; where do you sell them and how do you value them? Somebody may be lucky at an auction sale, but how do you value them? It may just depend on the particular whim of some guy who wants to buy them that day, maybe.

Senator Cook: And how do you get annual revenue out of them?

Mr. Godfrey: That is right, but people are not interested so much in the annual revenue as is shown by what happens to our dividend income. That is not what happens. People are looking forward to the long-term accumulations of savings and capital that they can retire on. But I think with very few exceptions people buy art for pleasure, and the big collectors end up by giving them away. There is the example of Mr. Zachs who had the largest collection in Canada, and before he died he gave a great deal of it away and I am sure that when Mrs. Zachs dies the rest will be given away. They are not collecting for profit.

The Acting Chairman: So you would be in favour of a restricted capital gains tax?

Mr. Godfrey: The Association is in favour of eliminating the capital gains tax altogether.

The Acting Chairman: But if you have to live with it, you would be in favour of a restricted capital gains tax?

Mr. Godfrey: I think theoretically you can make an argument for taxing residences above a certain amount, and theoretically you can make an argument for taxing objets d'arts and so on and theoretically you can make all kinds of arguments. But from a practical and equitable point of view, if they eliminated that, it would solve a lot of discontent. I just do not think it is going to be practical. I mean, for example, with a principal residence, if somebody rolls over their house and buys another one because they have got a better job, why should they have to pay a capital gains on the first one? It is not a question of getting a different job; they distinguish in the White Paper between getting a different job and getting a better job in the organization one is already working with. They have roll-over provisions in the United States.

The Acting Chairman: Thank you very much for that. Now, can we go back a little more specifically to your immediate problems. Your first suggestion is that in effect the mutual fund is an agency or a conduit only, and as such all profits made whether on capital gain, if there is a capital gain, or dividends or interest income is all cumulatively the income of the participants in the mutual fund and should be paid out to them.

Mr. Godfrey: Right.

The Acting Chairman: But being paid out to them is not in a taxing statute—is deemed to be paid out.

Mr. Godfrey: Well, in the States they say "must be paid out" and we would agree with that too. It must be paid out to them even though they can automatically reinvest it.

The Acting Chairman: In a taxing statute?

Mr. Godfrey: Right, it must be paid out to them. That is so that they can get their hands on it. They have to pay a tax on it and they have to have the money to pay the tax if they need it.

The Acting Chairman: Then with the withdrawal of the party, his position is pretty clear and all he is involved with is whatever accretions there are in respect of dividend income not paid at the time of withdrawal.

Mr. Godfrey: It is not that simple, and that is where we are having difficulty. We have

had three meetings with the Department of Finance and they explained the difficulties at the first meeting which apply either way. We thought they were pretty easy to solve. And we went back and we found them very difficult to solve. There would be no problem if you had one rate of tax. If a person redeems his shares, he pays his tax on redemption of whatever his capital gain might be. But if you have unrealized foreign gains in a portfolio and unrealized Canadian gains, how do you distinguish the rate of tax to be paid? This is putting it at its simplest. We have gone through every kind of permutation and combination to try to figure out what the unrealized gains were when you buy in and what they were when you sold out, and you take the difference and it does not work.

Without going into further technical details, we have finally come to the conclusion that the only practical way is to take the average per cent of the portfolio for the preceding two years in foreign and closely-held corporations, and compare that to the total value of the portfolio,—and you do that quarterly—to get this average and you just split the capital gain on that basis. If you had 25 per cent foreign and 75 per cent domestic, you would pay any gain on that basis. Now there are several other options we provide for. For example, you can have a fund that is all foreign and it is no problem at all. You just pay on the capital gain at the higher rate.

We have allowed another option; we have suggested to allow a little leeway for essentially a Canadian mutual fund investing in Canadian securities but allowing it to invest in a few foreign securities by saying as long as it never has more than 10 per cent of their unrealized gains at any time in foreign securities, then they can elect to have the treatment of being widely-held Canadian corporations. On realized gains there is no problem because they are going to be paid out at the end of the year and somebody is going to pay tax on them.

The Acting Chairman: Getting back to first principles, don't most of your problems arise from the fact that if you start to live in sin and integration, then you get all these complications, but if you eliminated an integration system and if you eliminated deemed to be realization, and if you simply said you had a capital gains tax in respect of realized profits, would not all the problems to which you have just referred be eliminated?

Mr. Godfrey: A lot of the inequities would be eliminated. But they do not have integration in the United States. They still have the conduit, flow-through treatment and it has turned out to be the most practical method.

The Acting Chairman: We have already covered that point, that the conduit treatment is all right in respect of interest income, dividend income and realized capital gains. But I am covering the point where the participant withdraws.

Mr. Godfrey: Right. No problem at all.

The Acting Chairman: If you eliminated the integration system and deemed to be evaluations, you do away with all its business between foreign capital assets and municipal or national capital assets, so you would have no problem at all.

Mr. Godfrey: None whatsoever.

The Acting Chairman: The complications arise because you start from a complicated premise.

Mr. J. D. McAlduff, Executive Vice-President, Investors Group; Chairman, Taxation Committee of the Canadian Mutual Funds Association: If I could interject here, Mr. Chairman, none of the problems we are speaking of here result from integration. The problems result solely from the fact that capital gains under the proposed White Paper treatment will be treated in two different ways. Some of them will be included in income to the full extent of the gain or loss and some of them will be treated whereby only one half of the gain or loss will be taken into income. This is the basis for our problem—not integration.

The Acting Chairman: That is why I am saying that if one abandoned the integration and one did not get involved in this whole business of foreign permissive income and deemed to be realization and all that kind of thing and if we approach the thing realistically—and here I am speaking for myself and not for my colleagues because I am today Acting Chairman of the committee; I am not the Chairman of the committee, but only a senator like the rest—but to me it would seem that on a capital gain you would pay a tax because you have made it on a specified asset period. Then all these complications would be done away with. And I want to know whether you with your experience in

the huge operation you are engaged in would agree with that simple thought.

Mr. Godfrey: Absolutely, because there is no problem in the States so far as taxation of mutual funds is concerned.

Senator Everett: Mr. Godfrey, you say you agree with the Chairman that the elimination of integration would eliminate all your problems. But your colleague seems to say the antithesis, and I would like to follow that along for a while to see if there is a real disagreement here.

Mr. Godfrey: Well, one of the problems in connection with the White Paper is that because of integration, the dividends on closely-held corporations cause us a problem under the White Paper proposals which probably would not apply if they eliminated integration. But I think I essentially agree with my colleague that the main problem here is the two rates of tax.

Senator Everett: Eliminating the closely-held corporations would not be, I imagine, a significant part of mutual funds.

Mr. Godfrey: That is right.

Senator Everett: Then let us deal with the widely-held corporations. In your judgment, does the integration provision create the difficulty you are talking about?

Mr. Godfrey: You are talking about the semi-integration?

Senator Everett: Yes.

Mr. Godfrey: No. We point out that on widely-held corporations there is no problem on dividends or capital gains under the White Paper proposals. They flow through and our shareholders are treated exactly the same way whether they own the underlying portfolio securities directly or not. Foreign securities and interest, yes. We have mutual funds that are balanced funds so that 30 or 35 per cent of their income could be interest income. The funds that I am the president of, are now from 28 per cent to 55 per cent invested in short-term securities, drawing interest, and quite a high rate of interest as we all know these days. So that is a real problem.

Mr. McAlduff: I think it would probably be well to add here, so there is no doubt about it, that we are not against the integration proposals, that as persons representing a large number of shareholders who are directly or

indirectly investing substantial sums in Canadian equities, we feel that these people will benefit from an integration proposal which will allow them some credit for the underlying tax paid by a corporation they invest in. I think we would be very foolish indeed to come out against such a proposal, because integration is better than no integration at all, as far as our shareholders are concerned; they are going to benefit from it tax-wise.

The Acting Chairman: Are you not impressed that you do get some benefit from the 20 per cent tax benefit with respect to dividends in Canadian corporations, so have you not got at least a substantial movement in favour of so-called equity on that score, in view of the complicated integration system? And if 20 per cent is not enough, would not the extension of that approach solve the problem for Canadian shareholders, from the point of view of getting a credit having regard to the corporate tax credit?

Mr. McAlduff: Very definitely, and as a matter of fact, the 20 per cent dividend tax credit is essentially a form of integration.

The Acting Chairman: That is why I put the question to you, because you said some integration is better than none at all, and I was pointing out the 20 per cent tax, and I am asking you if, whether you retained the present system without all the complications of integration, have you any suggestion as to what the credit rate should be in respect of dividend income? In other words, would an amount in excess of 20 per cent solve the problem? Have you given any study to it?

Mr. McAlduff: We did make some studies, as a matter of fact, after Carter came out, and a 50 per cent dividend tax credit would be very similar to full integration. A 25 per cent dividend tax credit would have roughly the same effect as the White Paper proposals would have, provided the corporation from which the dividend was received paid sufficient tax to allow a full gross-up in credit. So, very likely we would be open-minded towards the retention of the 20 per cent dividend tax credit as an alternative to the partial integration proposals in the White Paper, but the point we do want to make is that we would hate to see the 20 per cent dividend tax credit go out the window and yet have no integration proposals to replace it.

The Acting Chairman: Yes, I see that.

Senator Everett: Following that point along with you, Mr. McAlduff, and referring to your particular problem as a representative of Mutual Funds, I gather though the integration proposals do not pose a problem for a mutual fund?

Mr. McAlduff: No, no technical problem for Mutual Funds, as such.

Mr. Godfrey: Except for dividends of closely-held corporations.

Senator Benidickson: And foreign.

Mr. Godfrey: No, just closely-held, because there is not any integration on foreign anyway, but there is discrimination—and they say so in the White Paper, for reasons which I do not think are very logical—and they only allow half integration for dividends on closely-held, whereas everybody else gets full integration. They seem to think that because we invest in closely-held corporations for which we might provide the seed capital to start with. I have been personally an advocate for a long time that mutual funds should take a small proportion of their assets and actually invest in Canadian companies that are starting up. Even though they are not liquid and you have these valuation problems, we could serve a useful social function in that regard, but certainly we would not have more than 3 per cent of our assets in it, or something like that.

Senator Everett: If you did follow that course...

Mr. McAlduff: We have.

Senator Everett: ...to a greater extent, how would you value your shares for redemption purposes?

Mr. McAlduff: What we do is if there is absolutely no market at all for them to start with we continue to value them at cost, even though we suspect they may have gone up in value considerably. We do not increase the value, even though this might benefit continuing shareholders to the detriment of redeeming shareholders. If something happens that we know they have lost their value, and quite often they will go belly up, then you write them off, and write them off very quickly. That is one of the reasons you cannot go into it very heavily.

Senator Everett: In section 24 of your brief, on page 16, you talk about a double taxation

that is imposed. Could you tell me what you mean by that?

Mr. McAlduff: Senator Everett, that reflects, in effect, a pre-payment of tax and not a permanent double taxation. What it means is that if Shareholder "A" in a mutual fund disposes of his mutual fund shares to Shareholder "B", at the time there were unrealized gains in the underlying shares owned by the mutual fund, he would be taxed on these gains at the time that he disposed of his shares to Shareholder "B". Then, if shortly after Shareholder "B" acquired the mutual fund shares, the mutual fund itself realized on these previously unrealized gains and divided them out to Shareholder "B", he would pay tax on them. So the same gain on the same portfolio of shares has been taxed twice: firstly, in the hands of Shareholder "A" when he disposed of his interest in the mutual fund to Shareholder "B"; and, secondly, Shareholder "B" would also pay tax on the same gain.

Senator Everett: That could be avoided, could it not, if Shareholder "A" caused a redemption of his shares and Shareholder "B" bought new shares?

Mr. McAlduff: No, there is no way you could avoid it. This was just pointed out as a matter of interest. There is a temporary pre-payment situation whereby tax is paid earlier than it should be, but this will resolve itself when Shareholder "B" ultimately redeems his shares in the mutual fund, and this will manifest itself as a loss that he can deduct at that time, but temporarily there will be a double-taxation situation where two persons have paid tax on the same gain, but it will come out in the wash, eventually.

Senator Everett: If it was a long-term holder it could take some time.

Mr. McAlduff: Yes, a considerable amount of time, possibly.

Mr. Godfrey: You could also avoid double taxation. This is a technical thing we have not covered in the brief, but when the shareholder redeems and there are unrealized gains, you could take a portion of those unrealized gains and credit them against the realized gains and reduce the amount that you would have to pay out at the end of the year on realized gains, because the redeeming shareholder would have already paid a tax on that. That is technically permitted in the United States. It is usually only used by

mutual funds in the United States if the tax department claims at the end of the year that they did not pay out enough. They use this other method to avoid a penalty.

We did not think it was particularly significant. However, we now have figures that demonstrate that it could be significant, particularly in heavy redemptions which we have at certain times. That would be a further refinement to what we are suggesting, that when a shareholder redeems the fund should be credited for his portion of the unrealized gains so as to avoid double taxation.

Senator Molson: Is there any measure in numbers or money of foreign investment in Canadian mutual funds?

Mr. Godfrey: This is only a fairly recent development, within the last year or two. The figure we mention in our brief is \$51 million, which is mostly European.

It is a good type of investment to have, because they are not controlling any of our industries by investing in mutual funds.

Senator Molson: This has developed recently?

Mr. Godfrey: Yes, in the last several years.

Senator Beaubien: Mr. McAlduff, I would like to revert to integration. You made the point that the 20 per cent of your Canadian dividends is in a way a form of integration. The only aspect that seems to be criticized in the 20 per cent is that it is not enough. If the 20 per cent of the Canadian dividends was maintained and the corporation tax reduced from 52 per cent to 45 per cent, would the present form of integration of the 20 per cent not be sufficient? Of course, it would be a great stimulant to business. The big corporations create employment and development to make the country progress.

Mr. McAlduff: Yes sir, that would be the equivalent of a rough and ready 50 per cent integration rule.

However, as I understand it, the main objection of the Department of Finance towards continuing the dividend tax credit is that it is available to all Canadian corporations, whether or not they have paid any Canadian tax.

This is the reason that they have generally given for not continuing the 20 per cent dividend tax credit and substituting instead this partial integration law.

Senator Beaubien: There is that point, of course. However, with respect to Canadian corporations that do pay Canadian tax, if the corporation tax were reduced the 20 per cent that we have enjoyed for the last 17 years would be sufficient.

Mr. McAlduff: Yes it would.

The Acting Chairman: However, to pursue that objection, the declaration of a dividend can only come out of surplus.

It is true that at this stage of the game without a capital gains tax you may have a capital surplus on which to draw to declare the dividend, or earned surplus as the case may be.

If there were a capital gains tax all surpluses—forget that which has been accumulated to date—would be subject to corporate tax. Therefore the objection to which you have just referred falls to the ground. No corporation could pay out a dividend other than in respect of a profit on which it has paid a tax.

Cash flow resulting, for instance, from depreciation or factors of that nature, would not evidence itself in undistributed surplus.

Senator Everett: Could I refer the chairman to a situation such as Pine Point, where the corporation so far as I know will not have paid tax but will make distributions.

The Acting Chairman: That is a situation resulting from an entirely different principle applicable to a generic group under the heading of incentive legislation. Although there have been profits, tax holidays are granted. There will be undistributed earned income, but no tax paid because of a specified tax holiday or the special problems resulting from depletion, which is related to the extractive industries.

That is why under the White Paper and usually, indeed, in the tax structure, the extractive industries and incentive legislation are dealt with under a separate category.

Therefore, in the case of Pine Point there is declaration of dividends even though no taxes are paid.

However, we are discussing a very important point dealing with the whole question of integration as having a philosophical background which may or may not have some merit, which has not been discussed in this committee before.

If there were a capital gains tax in Canada, fundamentally in corporate law you could not

have in a corporate setup surplus available for dividend distribution that has not been previously taxed on a corporate basis.

Mr. Godfrey: The utility companies are a good example. I do not think Trans-Canada Pipelines has paid a nickel in corporate taxes since it was incorporated. However, it pays dividends. Consumers Gas is another instance. There is one set of books for tax purposes, showing the depreciation and so on, and another set for the shareholders. These utility companies go on for years without paying tax, because of high rates of depreciation, but they still pay dividends out of cash flow.

The Acting Chairman: How do they pay them out?

Mr. Godfrey: As long as they are not paid out of fixed capital.

The Acting Chairman: The dividend is paid from cash flow.

Mr. Godfrey: That is right.

The Acting Chairman: And such cash flow forms part of surplus.

Mr. Godfrey: There is a different set of books.

The Acting Chairman: Does it form part of surplus?

Senator Everett: Mr. Chairman, if deferred tax accounting is used it would create a statement which, through the deferred tax accounting would show a surplus out of which dividends would be paid. However, a statement placed on capital cost allowances would show no surplus. Therefore both you and Mr. Godfrey are correct, except that you can indeed pay out of a surplus on which no tax has been paid.

The Acting Chairman: In any event, let us not develop that further. There may be a cash distribution, but there is no such thing as a dividend within the meaning of corporate law other than in relation to the yield on capital invested, which is reflected in terms of undistributed surplus.

It may involve the issue as to whether there will be the necessity of defining what is a dividend in respect of which you are entitled to dividend tax credit. But in corporation law, I still say—and we do not want to get off into a seminar on law here—

Senator Benidickson: We are interested in taxation matters.

Senator Beaubien: And income.

The Acting Chairman: Yes. There is no such thing as a dividend from a corporation, which is a yield on capital invested, other than it is reflected through surplus account on profits.

Senator Cook: I agree, but is it not a novel situation that corporation law and income tax law are not the same?

The Acting Chairman: I think what does come out of this is possibly the point Senator Beaubien is making, that if we were to recommend the abandonment of an integration system, if we say we have to cloak ourselves in sanctity and look for the so-called justice that the White Paper is seeking, and if you were to retain a dividend tax credit system rather than an integration system, it might be necessary in approximating the system by reducing the corporate rate and retaining the 20 per cent tax credit to define what is a dividend for the purpose of the tax credit. I think that might be an interesting approach for this committee to study.

Senator Everett: I wonder if Mr. Godfrey would mind commenting on the Chairman's statement about the application of the tax dividend credit to certain dividends but perhaps not to others?

Mr. Godfrey: The whole point is that if you are going to have a dividend tax credit, you just have a dividend tax credit—period. It has nothing to do with the corporation paying tax, where it comes from or anything else. It is only if you have a semi-integration system that it matters. I do not think I quite agree with the honourable senator. For instance, again you are getting into a legal argument, but I do not think I would agree with your statement that dividends can only be paid out of profits. I think dividends can be paid out of any kind of surplus. If you have a one dollar par value share which you sell for \$10, you can pay dividends out of the \$9, and keep on paying dividends until you have got back to the dollar.

The Acting Chairman: Ah, yes, but you have a contributed surplus.

Mr. Godfrey: That is right, that is a contributed surplus; it is not an earned surplus.

The Acting Chairman: But it is still surplus.

Mr. Godfrey: I did not want some bad law to go into the record, that is all.

The Acting Chairman: It just shows the glory of the law!

Mr. Warren McEwan, The Canadian Mutual Funds Association: To expand Senator Beaubien's point further on the credit, I think we have to take into account personal income tax. We have been talking about the corporate level. Here we have personal income tax going up every year, and the credit relates to the individual's personal tax rate. I should like it to go on record that that has to be considered too, because it is inflationary, and therefore the tax credit of 20 per cent, if integration was not taken into account, would have to go up.

The Acting Chairman: Of course, Senator Beaubien's point is that if you increase the dividend tax credit to the individual, that is one thing; it is not employing people, or anything of that kind. But if you reduce the corporate rate of taxation, then you are creating an extra surplus and sinews of war for expansion, increased employment and the like, greater productivity, increase in the GNP, and all the ramifications that flow benefitwise from a reduced corporate rate, tied in with a retention of the 20 per cent tax credit, and justifying in the process, by the combination of the two, an approximation to an equitable system between corporate and individual shareholder rates without the necessity of introducing a complicated integrated system. I think that is Senator Beaubien's point.

Senator Beaubien: That is right. That is what I would say, although not as well.

The Acting Chairman: Are there any further questions, honourable senators?

Gentlemen, have you any further thoughts you would like to put before us?

Mr. C. Grant, Counsel, the Canadian Mutual Funds Association: Mr. Chairman, I would like to comment on something Senator Everett mentioned. He was concerned as to the importance of the investment of mutual funds in closely held securities. Bearing in mind the concept that we view everything other than widely held as being closely held, apparently at the end of 1969 Mutual Funds Association had total investments of \$2,677 million, of which \$1,084 million were invested in Canadian equities. It is possible that even some of those Canadian equities might have been closely held, but one thing we do know

from this is that the remaining things, forms of investment, would not qualify as widely held, so we had over \$1 billion at the end of 1969 in non-widely held securities, and it is the distinction between the taxation of gains on widely held securities and gains on something other than widely held securities that creates this problem, which we found so difficult to solve.

Senator Everett: You say that \$1 billion are not classified as widely held?

Mr. Grant: At least \$1 billion would not be classified as widely held securities, according to our statistics.

Mr. Godfrey: Most are foreign.

Senator Everett: I was going to say, the majority of that would be foreign investment.

Mr. Grant: Foreign or bonds.

Senator Everett: The percentage in actual closely held situations would be rather limited, I suppose?

Mr. Grant: By that you mean private Canadian companies?

Senator Everett: Yes.

Mr. Grant: Yes, generally speaking I think that is true.

Mr. Godfrey: All of those, incidentally, would be companies which you would expect to be going public within a year or two, or three.

Senator Everett: That would be part of a shepherding process.

Mr. Godfrey: That is right.

The Acting Chairman: Are there any further questions, honourable senators? Then we are grateful to you, Mr. Godfrey, and your colleagues.

The Acting Chairman: Honourable senators, the next brief we have to consider is from Investors Group Trust Co. Ltd. We have here Mr. J. N. W. Budd, the President; Mr. J. D. McAlduff again, whom we have just heard, the Executive Vice-President; and Mr. B. J. Condy, the Assistant Vice-President.

Mr. Budd, you have seen the way we approach things, by way of concurrence, dis-sidence, questions and answers. We will start

off by asking you to summarize the contents of your brief.

Mr. J. M. W. Budd, President, Investors Group Trust Co. Ltd.: Thank you, Mr. Chairman. Honourable senators, my colleagues and I are appreciative of this opportunity to appear before you and make the points in our brief.

Investors Group Trust Co. Ltd. is the pension arm of The Investors Group. We act on behalf of almost 1,000 corporate pension plans and 26,000 registered individual retirement savings plans. In total we are responsible for the management of \$220 million of pension assets and \$85 million of individual registered retirement savings plan assets.

The pension and registered retirement savings plan services of this company are distributed through the 800 sales representatives of Investors Syndicate Limited. Because of this fact we have considerable exposure to small businessmen and professional men from coast to coast. We do business with a good many of them and we feel we understand their particular needs in so far as building retirement income is concerned. These taxpayers are by nature independent people who have chosen to build businesses and careers outside of the security of large corporations and/or government or institutional service. As a group, it can be stated they are desirous of creating a position of self-reliance for themselves and their dependents so that in later life they will be able to enjoy an appropriate standard of living in their retirement years.

Under the existing provisions of the Income Tax Act, and in the proposals contained in the White Paper on Tax Reform, they are precluded from doing this on a basis equitable with other categories of taxpayers. We advocate that equity be achieved, not by removing the tax shelter provisions now enjoyed by salaried employees of business and the public sector, but rather by extending them to all categories of taxpayers.

Subsequently in this submission we have concentrated on an area of tax legislation which we believe is badly in need of reform; namely, the provisions that would allow all taxpayers to accumulate a pension or retirement income on a tax-sheltered basis.

We show that despite the huge revenue cost of the existing tax relief provisions for pension plans, only a small percentage of taxpayers are able to take advantage of them. Indeed, more than half of the tax benefit is

being enjoyed by the less than 13 per cent of taxpayers who belong to public sector pension plans.

We demonstrate that the Registered Retirement Savings Plan provisions in Section 79B of the Income Tax Act are inadequate. The contribution limits in that section fall far short of what is needed to provide a reasonable retirement income. For this purpose we have used the federal civil service pension as a model of a "reasonable retirement income".

We are in complete agreement with the statement in the White Paper that it is desirable for the Government to encourage personal savings plans for retirement, but that it must be done on an equitable basis, available to all. On the other hand, we object to the White Paper's statement that "revenue considerations" prohibit a switch to a more equitable system at the present time. We point out that the huge revenue costs of the existing tax concessions for pension plans are undoubtedly resulting in substantially higher tax rates than what would otherwise be the case. These higher rates apply to the income of all taxpayers, including those who presently have to provide for their retirement income with after-tax dollars. We therefore submit that the changes needed to extend this important tax benefit to all taxpayers should form part of the present tax reform package, and should not be postponed until "revenue considerations" permit.

In our brief we make some specific recommendations which, if adopted, will ensure a much fairer distribution of the tax burden among different classes of taxpayers. We also outline a practical plan for implementing some of our major recommendations.

Finally, we show that these suggestions will not only distribute the tax burden on a fairer basis, but will also prove beneficial from both an economic and social standpoint and should contribute to greater understanding of and voluntary compliance with our tax laws.

We wish to thank you for allowing us this opportunity to state our views and answer any questions you may wish to ask us concerning the positions presented in our brief.

The Acting Chairman: Mr. McAlduff, would you like to develop a little further the nature of the recommendations made in the brief?

Mr. J. D. McAlduff, Executive Vice-President, Investors Groups Trust Co. Ltd.: Yes, Mr. Chairman. Probably I could start by saying that our brief is somewhat unique in that almost everyone, both in Government

and otherwise, agrees with the principles that we have stated in our proposals. That is, that registered retirement savings plans or pension plans which are based mainly in a manner whereby persons are endeavouring to provide out of their earnings for the retirement years, should be available on an equal and equitable base to everybody and not just to certain segments of the population.

For example, the Carter Report very clearly stated this and devised a plan which was not too dissimilar from our own.

In the discussions after the Carter Report came out, most of the comment was predicated and based or related to the maximum income of \$12,000 per year that Carter proposed, rather than the justice behind setting a maximum limit that would apply to everyone, whether self-employed or an employee or whether one worked for a large organization such as a government which has a substantial pension plan—or a large and well-established corporation, for that matter—or worked for a new upstart company which cannot afford to put in such a generous pension scheme.

Subsequent to this—this is not generally too well known—the Prime Minister himself appointed a citizens committee earlier in 1969, made up of knowledgeable persons in this field from the private sector of the economy, to suggest possible tax changes in the area of retirement benefits.

The committee was made up of a practising lawyer, of senior officers from the trust company, from a life insurance company and from a major employee benefit consulting firm. The fifth member of the committee was quite a prominent Canadian who has served on royal commissions in the past, who is a fiscal consultant and who in fact was a senior member of the Carter Commission staff closely involved in the pension area.

The unanimous recommendations of the committee were completely compatible with the recommendations in our brief.

In spite of all of this background—all of which, by the way, was available to the persons in the Finance Department who prepared the White Paper—they approved the concept in principle but rejected it on the basis that it was so expensive that the Government could not afford to implement it at that time.

The Acting Chairman: Will you state what the conclusions of that committee were?

Mr. McAlduff: I could give you a copy.

The Acting Chairman: Would you like to give us a copy of that, and probably honourable senators would like it to form part of the record?

Hon. Senators: Agreed.

Mr. McAlduff: I will file this copy.

The Acting Chairman: Before you hand it over to us, would you be good enough to summarize that, because I believe that the deliberations of that committee are not too well known.

Mr. McAlduff: Yes, Mr. Chairman.

The principal conclusion of the committee subscribed to by all members might be stated as follows.

Any taxpayer should be entitled to provide from pre-tax income a retirement benefit which would enable him and his spouse to have and maintain, throughout retirement, a standard of living related to the standard of living he had attained during his working lifetime. The provision of such a retirement benefit should be seen as the deferment of income from working lifetime to retirement period. We agree that tax should be deferred both on the amounts of income that are set aside and on the investment income derived therefrom during the period of deferment. The full amount of benefits should, of course, be taxable when payable. As tax deferment is involved it is accepted that some limit must be placed on the amount of the tax benefit.

It is a corollary of this conclusion that the taxpayer might be an employee, a shareholder, a partner or a sole proprietor and that this should not affect his entitlement to tax shelter for the provision of his retirement income.

Further we are agreed that there should be no restriction on the duration of the working period from which a taxpayer may defer income to retirement.

There were some further recommendations but that was the main gist of the report.

The Acting Chairman: What was the ceiling of proposed relief, Mr. McAlduff?

Mr. McAlduff: The pension must not exceed \$40,000 per annum, available from age 60, although the suggestion was that this should be tied to a wage index and should increase as wages generally increased.

In addition, we agreed that, for practical reasons, the pension limits in the current Department of National Revenue rules might

be used to establish such value limits. We recommend that the total value of a tax-deferred retirement benefit of the taxpayer from all his registered plans not exceed the value of a pension of 70 per cent of the average "earned income" of the taxpayer during the five consecutive years in which his "earned income" was highest. The pension used to establish this value limit would be payable from age 60 and continue in full after the death of the pensioner to his spouse during her lifetime.

It is not too dissimilar, by the way, from the type of pension which is provided under the present Civil Service Superannuation Plan. It is substantially the same.

The Acting Chairman: And generally followed by big corporations.

Mr. McAlduff: To quite an extent, yes. There are further details set out therein, but basically this was what we suggested, that every taxpayer should have the right to provide a pension, not of 2 per cent per year service, because we considered that, by the time everyone reaches retirement age, at 60 or 65, he presumably has spent a lifetime in the work force, so the 2 per cent per year of service is practically meaningless as far as he is concerned. He has to maintain a standard of living.

We suggest therefore that at retirement age 70 per cent be available to everyone based on his best five consecutive years with this maximum of \$40,000 per annum for a person retiring today, but with this \$40,000 limit being tied to a wage index so that it would go up and would continue to have the same meaningful relationship it has now. Therefore, the earnings of people retiring would continue.

Senator Beaubien: How would this fund be financed? A man could put aside so much a year tax-free?

Mr. Budd: That is right.

Senator Beaubien: How much could he put aside? How are you going to arrive at \$40,000 income?

Mr. Budd: Forty thousand dollars a year income is the maximum and would only apply to a person whose earnings were such that 70 per cent of his earnings would amount to \$40,000 a year.

Senator Beaubien: How would he set aside enough money for that \$40,000 amount?

Mr. Budd: He would have to save it.

Senator Beaubien: How much could he save? Is it a tax-free saving?

Mr. Budd: Exactly. That is the precise point. In order to provide this type of pension a person should be allowed to set aside whatever amounts are required to fund it.

This is what is happening now in the case of persons who are working for employers who provide this type of generous plan. The employer sets it aside on his behalf. We feel that there is no difference between that situation and one whereby a person receives all his remuneration or earnings in cash and has to provide out of these earnings, the same level of benefit. He should be getting a tax deduction as long as the amount he is setting aside is not excessive and not greater than what is needed to provide this level of pension.

The plan we have suggested in our report, by the way, was approved by this committee. It is a slight variation of this plan, approved by the committee I was mentioning. The one main difference is that the plan we propose provides for funding through a person's working lifetime rather than allowing the person who is, say, aged 35 to throw enough money into the pension fund to provide for his whole pension as of age 60 or 65. We believe it is possibly more appropriate to say that if you are aged 35 and it is 25 years to retirement date, 1/25 of the amount will be put away a year, and so on each year. But, on the other hand, if a person has reached the age of 55 and has not put anything away, he should be able to purchase this whole lump sum and claim a tax deduction for it, if he has the money available, which by the way is a very big "if".

If you examine the figures in our statement you will see how very, very expensive it is to provide a retirement income for oneself. Few persons realize how expensive this is and how valuable the pension benefit is if they are employees who are fortunate enough to be covered by such a plan, but the main basis of our argument is an attack on the Government's White Paper position, that it cannot afford to introduce this benefit to give equity at the present time because there seems to be no denial at all that this equitable type of proposal is desirable, if we can afford it.

Senator Beaubien: One other question. What can a civil servant earning \$30,000 a

year put aside tax-free according to the Government plan?

Mr. Budd: Well, he would not be able to put anything aside tax-free in addition to what the Government plan has provided because at his retirement date the actual equivalent lump sum purchase value of his pension at age 60 would be something better than \$300,000. That is what the Government would have put aside for him.

Senator Benidickson: But he would have paid half the cost of that benefit, would he not?

Mr. Budd: He would have paid approximately 1/7 of the benefit, according to statistics we have from the Public Accounts of the Government of Canada.

The Acting Chairman: Mr. Budd, if I may interrupt, I do not think you have quite answered Senator Beaubien's point and that is, this maximum to which you are entitled is the average of the five years preceding your retirement.

Mr. Budd: Yes.

The Acting Chairman: How, first, would a man know what he was entitled to, because you project so long into the future, five years prior to retirement, and, second, surely there must be some limit to the amount you can take from your taxable income in any given year. That is what I am trying to find out.

Mr. Budd: The amount to be put aside is really an actuarial problem, but in the suggested solution, that I have attached as an appendix to our brief, we have worked out a method which is workable and which would solve this particular problem.

In essence, what this boils down to is the fact that a person in all of his retirement plans, including his Government plan if he has one, would be able to accumulate an amount equivalent to ten times the average of his best consecutive years' earned income to date.

This is the maximum amount that he could accumulate and the suggested solution here goes on to say that with a reasonable means of correcting variations that will occur, this will be a workable solution. This amount of ten times will provide him with approximately a 70 per cent pension based on his best five years' earnings.

Senator Beaubien: Now, just before we go on any further, if I am a civil servant getting \$30,000 a year, what can I put into this fund tax-free? Does the Government do it all or do I put in anything myself?

Mr. Budd: Let me put it this way. If you were not a civil servant and you were earning \$30,000 a year, at age 60, if you were ready to retire, under this plan you would be permitted to put in an amount up to \$300,000. That would be the maximum amount you could put in; ten times your earnings. However, assuming that you are a career civil servant with a full 70 per cent pension from the Government, the plan would require an evaluation of the value of this benefit you have accumulated under the Civil Service Superannuation Plan, and if the value of that benefit is greater than \$300,000, which it would be, you cannot add anything. On the other hand, if the value is less than \$300,000, you can add such amount as is necessary to bring it up.

Senator Beaubien: So what you are saying is that you take it off my income tax and put it into your...

Mr. Budd: Yes, provided you invest it; provided you actually take this money and invest it into a retirement savings plan of some sort or another.

Senator Cook: In theory you do not want to put it into savings. You already have your pension provided for.

Mr. Budd: That is right, in the case of the civil servant you are mentioning.

Senator Cook: Yes.

Mr. Budd: The civil servant is in a fortunate position. If he works for the Government for his lifetime, he will have had provided for him the type of pension and the type of retirement income that we are trying to make available for the rest of the people in the country, for the other 96 per cent of Canada.

Senator Beaubien: We would all work for the Government.

Mr. Budd: That is right, but the basic difference here is that all we are asking in this brief is that people be allowed to provide such pensions with their own money and be given a tax deduction for it.

Senator Hays: Deferred.

Senator Everett: Mr. Budd, you propose a form of quinquennial re-evaluation, I gather, for this plan. Is that correct?

Mr. Budd: Yes, we do, because it is recognized that variations will occur. You see, nobody knows exactly what the cost of providing retirement income would be. It is dependent upon a number of factors. One is the interest return or investment return you will have on the invested money. Another is the longevity of the person. How long will he live? If he died the day after retirement naturally the cost of the plan would be considerably less than if he lived to be 100 years old.

Another factor, since this type of plan is related to their earnings after retirement, is how swiftly will their earnings rise? Therefore, any plan at best is a reasonable estimate of what amounts should be set aside each year and must therefore provide for a correction of variances as they come to light, and this quinquennial evaluation will provide for correction of these variances. If it turns out that the investment earnings are less than what was anticipated or if the man's earnings have gone up at a greater rate than what was anticipated, then there will be less than sufficient moneys in the plan, and if this happens, you will be allowed to add enough money to bring it up to maximum. If on the other hand his investment earnings were greater than were anticipated or if his earnings did not go up at all or if accumulated benefits in some other plan, such as if he joined the Civil Service or went to work for a large corporation that had a generous pension plan, and he accumulated benefits during this five-year period, there would be too much money in the plan and in that event this excess would be taxable in his hands and he would have to bring it into his income, which is a fair enough solution because his benefits have accumulated during that five-year period. But we have suggested a means whereby any surplus would be spread for tax purposes over the previous five-year period during which it arose.

Senator Everett: I wonder if I might ask you whether the differences in the five-year revaluation might be quite large; in other words, I assume that the taxpayer would have no knowledge of what he was supposed to contribute and he would have to get advice from the company with whom he was investing his funds. Could those errors, taking into account the variation in a man's income

and the variation in interest rates and returns on investment—could those errors be fairly substantial?

Mr. McAlduff: I would suggest not. They would not be dissimilar from the type of variation that results from the triennial or quinquennial valuations of pension plans. Generally speaking, the deficits or surpluses that arise in pension plans are not too out of line.

Senator Everett: That is fine. Then on page 2 of the appendix to your brief, you state in item number 2—and I imagine this is a general rule of thumb in your business—that at age 60 the cost of a pension is fifteen times the income to be provided. But in item A of the main proposal farther down the page, and as you have mentioned in your verbal evidence, the norm that is used is ten times the largest five consecutive years of income. Can you explain the difference between the ten years and the fifteen years?

Mr. McAlduff: Yes, I can, Senator Everett. Fifteen times the pension is the cost of the actual dollar amount of pension purchased, and we are endeavouring to provide a pension that is 70 per cent of a person's earnings.

Senator Everett: To be more precise, you are working at 66⅔ per cent.

Mr. McAlduff: No, 70 per cent. Just to give you an example; if a person's average earnings were \$10,000 per year, we are trying to provide a pension of \$7,000 per year. As we pointed out, the cost of this pension would probably be approximately 15 times that amount, and 15 times \$7,000 is \$105,000, or, in round figures, about 10 times his earning figure of \$10,000.

Senator Everett: Yes, but let us not put it in round figures. Let us be precise. After all, you are more accustomed to being precise than I am.

Mr. McAlduff: Well, ten was a good figure to round it out to, and mind you this figure of ten times is put in for discussion purposes only. It could be subject to change; it could be seven times or twelve times depending on what persons in their wisdom believe to be the necessary amount.

Senator Everett: Yes, it depends on the figure, but I could see the fifteen times being used as a rule of thumb. So what you are doing is attempting to provide 70 per cent.

Mr. McAlduff: Yes, precisely.

Senator Everett: You say this figure will provide a widow's benefit and protection against inflation. Would that be an increment of, say, 2 per cent a year or 3 per cent a year?

Mr. McAlduff: Yes, approximately. You will notice that we did some calculations of the value of the existing Civil Service plan in statement number 3, and the plan we used as a model here was for a male retiring at age 60 with a wife five years younger than himself, receiving 70 per cent pension of his final earnings with the proviso that in the event of his death the widow would receive half of his pension for the remainder of her life, and that the pension would increase by an amount of 2 per cent each year after retirement, and the value of such a pension, assuming a 5 per cent increased yield, gave a cost of about \$16.53 for each \$1 per year pension using a 6 per cent interest yield and it was just under \$15. So we rounded this out and used a \$15 figure.

Senator Everett: Looking at statement number 3, and speaking in terms of present pensions, where would you say the median is? Is it \$10,000 or \$15,000? I am asking just for a rough median.

Mr. McAlduff: Per person receiving pension?

Senator Everett: Presently receiving pensions.

Mr. McAlduff: Very much lower than any of these figures, and for a number of reasons. I might mention that even in the Civil Service it is very much lower because in most organizations the pension is limited to something like 2 per cent for each year of service. Now if you consider that persons retiring today in 1970 from the Civil Service had to have started work in 1935 in order to get their full 35 years in, and if you also consider that the great growth in the Civil Service was long after the depression, only taking place during the war years and later, there are relatively few civil servants retiring today who have anything like 70 per cent pension. However, this will change in the future and there is a much greater likelihood that 10 or 15 years from now these figures will be much more valid, and the actual actuarial cost of the Civil Service Plan will bear this out. It is an enormous cost to the Government and the people of Canada in funding that plan today.

Senator Everett: Following from that, this is an annual contribution starting at what age?

Mr. McAlduff: Statement number 3 is not an annual contribution. This was drawn up to reflect the value of a pension and the date the pension started. In other words, for a person who reached age 60, this is what it would cost them to go out and buy \$7,000 a year pension of this type with all these frills and embellishments, and they would have to plank down \$103,000 to buy this type of pension, presuming that the insurance company was working on the basis of 6 per cent interest. At the present day they are working on better interest rates than that and in the future it will probably be somewhat less. A few years ago, and a few years from now, they will probably be working at a lower interest rate and it will cost more.

Senator Everett: Then in statement 4—let us take a person who is earning, say, \$100,000 starting at age 25. You start at age 25, do you?

Mr. McAlduff: Yes, starting at age 25 would give a person the full 35 years to accumulate his pension before he would reach the age of 60 and retirement.

Senator Everett: And would he be required to contribute \$105,000 in that period?

Mr. McAlduff: He would, if his earnings ever increased from \$10,000 a year, but in actual fact...

Senator Everett: I do not think we need to get into that.

Mr. McAlduff: Well, the \$105,000 applies to the person who is age 60 today and would like to go out and buy a pension of 70 per cent of \$10,000. It has no relationship to persons starting their pension program at an earlier age.

Senator Everett: Except that 35 times 3,000 is 105,000.

Mr. McAlduff: It is just a coincidence.

Senator Everett: \$105,000 has to be contributed?

Mr. McAlduff: Yes.

Senator Everett: And in the case of \$20,000 it goes to \$6,000?

Mr. McAlduff: Yes.

Senator Everett: In order to provide this pension?

Mr. McAlduff: Yes.

Senator Everett: Can that be provided under your plan by an employer or employee to any extent?

Mr. McAlduff: It can be for employer-sponsored pension plans and, indeed, this is happening with many of them, that pensions comparable to this and at cost comparable to this are being provided on a tax-shelter basis, but no one on an individual basis can contribute more than \$2,500 a year into a pension plan. That is the maximum allowed under section 79(b).

Senator Everett: So that if it were an individual who presently operates under a registered retirement savings plan and he is presently allowed to deduct \$2,500 a year or, in the case of the \$20,000-a-year man, \$2,000 a year, his deduction would move to \$6,000 per year, is that correct?

Mr. McAlduff: That is right. That is what he would want to contribute to a program started at age 25 in order to provide him with the amount of capital needed to pay a 70 per cent pension when he retires. It seems like a great deal of money, nonetheless it is true that this is what he would have to put aside, unless he could hope for spectacularly high earnings during the working years, but this is based on two assumptions conflicting with each other. One is the assumption of the rate his earned income will rise at, and everyone knows that earned income is going up each year. And the second is, what type of investment return he will receive on his invested monies.

Senator Everett: Following this line of questioning through to asking a final question, which is the one I have been leading up to, have you calculated, roughly, the cost to the Treasury of the introduction of your plan based on the present participants in pension plans in Canada? I am referring specifically to that set of statistics that is contained in Statement 1. Have you assessed the cost to the Treasury, if you then try to think of the people who might come into a pension plan but who are not already in a pension plan, by virtue of this more generous treatment—or, to put it another way, more fair treatment?

Mr. Budd: If you had total exposure, it would be colossal.

Senator Everett: I guessed that.

Mr. Budd: It is difficult to know to what extent you would get increased exposure. This is one of the tough parts in arguing for equity, but what we are suggesting is this, that there are those people who are in a position to provide a greater pension and they should be permitted to do so. The Department of Finance's argument is that we cannot afford it. How do you arrive at it Table 1 is a very interesting table which perhaps Mr. McAlduff would like to comment upon.

Mr. McAlduff: Maybe I could add a little to this. As Mr. Budd said, it is very difficult to estimate the cost to the Treasury of such a proposal, because it is difficult to predict with any degree of precision how many persons will take full or partial advantage of it, but we do have some experience in this field. I might refer back to the Carter Commission Report, for example, where they estimated that their proposals in this respect would cost at least \$50 million per year. I do not think our proposals are all that much more expensive than the Carter proposals, because they suggested that anybody be allowed to fund at any time the whole lump sum required to provide their retirement income in one year, regardless of age. We have suggested a mitigation of our proposal whereby this would be spread over the years they have remaining to retirement date, which would cut down the cost.

Senator Everett: But you feel the cost of your proposals, as you see the present state of pension plans, would likely not exceed \$50 million a year?

Mr. Budd: Revenue cost.

Senator Everett: That is extremely reasonable to accomplish what you are trying to accomplish.

Mr. McAlduff: That comes from Carter. I would put a probable top cost of \$200 million a year on this. Again, this is guess work; this is seat-of-the-pants reckoning; but we have a good idea of how much money has gone into registered retirement savings plans under the present \$2,500 limit. We know that the great bulk of Canadians who could take advantage of registered retirement savings plans are not taking advantage of them. We also know that those taking advantage of them are fully assured of this \$2,500 a year maximum limit. So this will not create additional Government revenue loss in respect of anyone who pres-

ently is not putting the \$2,500 a year in. So I think it would not be unreasonable to put a top cost per year of \$200 million, and I think that would be very high.

Senator Carter: I want to ask how realistic these figures are.

The Acting Chairman: On which page?

Senator Carter: On Statement 4. A person earning \$7,000 at 25 years of age is very likely married with a couple of children. How could that person with \$7,000 a year pay \$2,100 into a pension plan?

Mr. Budd: That is precisely one of the most important points in our submission, that he cannot and will not be able to, and even if he could he probably has not the desire to tie his money up because, after all, at age 25 retirement age is a long way off. So the point of our submission is that a person who is a late saver, who does not start putting money away until perhaps he is age 40 or 45, should be allowed substantially higher limits in order to permit him to catch up.

Senator Carter: Can anybody in actual fact, get into this plan? Can he actually accumulate savings?

Mr. McAlduff: Yes, if he is a good enough saver. In essence, a person 15 years of age could provide this type of plan by putting away 30 per cent of his earnings each year. This 30 per cent could be cut down if he is willing to assume a little risk and invest in securities that will have higher than a normal rate of return. In that event he could possibly fund that with a 20 per cent contribution, but I doubt very much that a final earnings type of plan could be funded by contributions of certainly not much under 20 per cent of a person's earnings each year, on average.

Mr. Budd: The purpose of this table really is to illustrate the point that it is terribly costly to accumulate what is deemed under, say, the model plan used a reasonable retirement income. It is virtually impossible, but what we have pointed out below it is the maximum contribution allowable under section 79(b), to illustrate how inadequate that really is to get anything near an adequate pension. This table in itself is an unrealistic figure because people cannot provide it. What we are arguing for here is trying to put before you the fact that section 79(b) is not adequate for a person who is self-employed to accumulate money out of pre-tax dollars to

give him anything like a reasonable income in later life, and we are arguing for an upper limit on that.

Furthermore, a number of people in the country who have poured a lot of time and energy and all their savings back into their business for many years are approaching later life and now want to start creating a pension, and we want those people to have an opportunity to be able to put more money away on a tax shelter basis.

The Acting Chairman: Would it not be simpler, in view of the difficulties and uncertainties referred to in the schedules, to have a recommendation increasing the amount deductible of \$2,500, for instance to \$5,000 flat to all or, alternatively a percentage of taxable income?

Mr. McAlduff: No, this will not perform the needed function. Five thousand dollars a year for all is going to be far too high for certain persons and far too low for others. For example, for a person who starts his savings program at age 25 it will be considerably in excess. For one who starts his program at age 45 or later it is insufficient. It is a meaningless figure.

In addition, it does not take into account other investments or retirement savings plans a person may have managed to set aside on a tax shelter basis. Only a system such as this could be considered to be truly equitable. The main objection in the past has been a fear that a practical working system could not be devised, but this exercise illustrates that one could be.

The Acting Chairman: Is it equitable for the average person? According to your plan a person in a high income bracket would be allowed to deduct in one year a sum of money from his taxable income which will provide a pension estimated on the basis of 70 per cent of average earnings from age 55 to 60. For instance, a person at 50 years of age wishing to retire at 60 and in the 70 per cent bracket according to your plan is allowed to deduct from taxable income a huge sum of money in order to work out 70 per cent average of his income from age 55 to 60. The tax benefits to him could be very considerable.

Mr. Budd: Our approach to this is somewhat parallel to that of the Carter Commission, which recommended this type of system. There could be a lump sum funded in any given year.

Our suggestion is that the upper level should be 70 per cent, with a maximum of \$40,000 per year. The Carter Report on the other hand contained a recommendation for an upper maximum of \$12,000, but as far as funding is concerned the late savers would have the advantage of putting away more.

The Acting Chairman: There is no doubt about it. The cost to the Treasury is one of the problems with your plan.

Mr. McAlduff: There is no inequity involved. We are endeavouring to equate the position of the early savers with that of the late savers.

The Acting Chairman: But is the last saver entitled to equalization?

Mr. McAlduff: Very definitely so.

The Acting Chairman: Particularly if he is a late saver in a very high bracket?

Mr. McAlduff: This would be more than offset. The early saver is the person who obtains the greatest cash benefit under such a plan.

Bear in mind the fact that the main benefit under any beneficial tax legislation in this respect is the deferment of payment of tax, and not absolute saving in tax. The longer the advantage will be.

This is illustrated in the exercises both in the Carter Report and the White Paper. A person who starts saving at age 25 and at age 50 has built up a fund of \$100,000, will get a greater benefit than the person who has put nothing into his fund, reaches age 50 and is allowed to put in \$100,000 in a lump sum in one year and claim deduction for it. This can be mathematically proven with a considerable degree of certainty.

There is a prejudice, of course, against allowing a person to claim a substantial reduction in any particular year. This is mainly due to ignorance of the fact that other persons who have accumulated comparable benefits to date have actually a vested interest in an equivalent sum of money. This has been built up at no tax cost to them to date.

The Acting Chairman: Yes, but at the same time we reduce the standard of living of younger men who marry. They are probably prevented from educating their children, et cetera, in order to obtain the benefit of comfort at 60 years of age. On the other hand, certain people roll along nicely without providing such a plan. When they get into the

high brackets they can realize a tremendous tax benefit because they are in a graduated reduction income tax.

Senator Cook: Plus the fact that it is not realistic to say that a person earning \$12,000 could put aside \$3,000.

Mr. McAlduff: I might point out, of course, that these benefits are not mandatory, but permissive and simply set out maximum amounts that a person can set aside should he deem it advisable to do so.

In point of fact, most persons will not put away this amount of money. A great many will set aside varying sums, but much less than this.

The Acting Chairman: I have a feeling that from a practical standpoint, because of the cost to the Treasury and the other factors discussed, one could get relief by increasing the annual payment across the board even though it might not be equitable by and large. Alternatively, deductions could be related to a percentage of taxable income.

Mr. McAlduff: As I pointed out, neither of those will produce anything close to real equity in our tax system. Both will continue the present system, under which tax-tax-privileged individuals are able to reap tremendous benefits which are denied to others.

Senator Benidickson: In preparing the appendices and the brief in general, why did you select examples not typical of the majority of retiring people? You refer to the expense of your recommendations to the Treasury. Why did you select the age of 60, which is not really typical of the age at which people retire on pension plans. It would be more like 65 years of age.

The figures you present would not have been as expensive to the Crown had you used 65 as a basis rather than 60.

Mr. McAlduff: The reason for the selection of the age of 60 is because this proposed system is permissive, not required. Therefore it would be available to persons who wished to retire at the age of 60 to put aside a sum of money to provide a retirement income at that age. Those who would rather retire at the age of 65 or 70, of course, would be permitted to pay correspondingly smaller amounts.

The second point is that by far the most expensive plan to the Treasury in this country is the civil service plan, which permits retirement at the age of 60.

Our feeling is that the self-employed person, the man who works for a small, growing company, who has changed jobs frequently enough that he does not have a vested interest in the company, is entitled to as great a pension on a tax shelter basis as are civil servants.

The Acting Chairman: Are there any other questions, honourable senators? If not, I wish to thank you, gentlemen, for a very interesting brief.

The committee adjourned until 2.15 p.m.

Upon resuming at 2.15 p.m.

The Acting Chairman: Honourable senators, the next brief we are going to hear is from one of Canada's outstanding oil companies, Texaco Canada Ltd. The gentlemen whom I would like to introduce to you are: Mr. H. A. Farquharson, president; Mr. D. F. Bentley, Vice-President and Counsel, and, incidentally, one of my closest friends at the Quebec Bar; Mr. O. C. Windrem, Tax Administrator for Texaco Canada, and Mr. K. O. Fowler, Assistant Tax Administrator.

Honourable senators will have before them some supplementary material which has been submitted and which in due course will formally from part of the record.

Mr. Farquharson, we are glad to have you here today with your associates. Would you be good enough to give us a summary of your views and presentations?

Mr. H. A. Farquharson, President, Texaco Canada Ltd.: Thank you, Mr. Chairman and honourable senators. First of all, I would like to thank you for the opportunity of presenting and discussing with you our company's views and recommendations supplementing our formal submission. As Mr. Chairman has mentioned, I am accompanied by Mr. D. F. Bentley, Vice-President, General Council and Director; Mr. O. C. Windrem, our Tax Administrator; and Mr. K. O. Fowler, Assistant Tax Administrator.

Texaco Canada is a fully integrated oil company, engaged directly or through subsidiaries in exploration, production and refining of crude oil and in the marketing of petroleum products throughout Canada. Our origins date back to McColl and Anderson founded in Toronto in 1873. We now have 3,500 employees, nearly all of whom are Canadians. We operate four refineries and market through some 4,600 retail outlets.

Ninety-two per cent of our 5,900 shareholders are resident in Canada and own approximately 30 per cent of the company's common shares and nearly all of the preferred shares.

Our company has given careful study to the White Paper proposals in relation to their direct impact on Texaco Canada's operations as well as their likely effect on the business environment in which the company operates.

Speaking generally, first of all, it is clear, as the White Paper implies, that an additional burden would be placed on resource-based industries because of the proposed reduction in incentives, which, we submit would inhibit their progress and development.

Secondly, it is less clear what the overall effect would be of increased personal taxes, the abolition of the dual rate on corporations, the segregation of corporations into two groups and taxing them and their shareholders differently, and the imposition of a capital gains tax at a rate among the highest in the world upon Canadians who have never been subjected to such a tax.

The economic effects of the additional tax burdens on taxpayers and the enormous problems associated with adjusting to a new system may well have serious repercussions not only to corporate and individual taxpayers but also to governments themselves.

We believe tax reform should be an evolutionary, not a revolutionary process to permit the system to adjust gradually, thereby providing opportunities to retract measures with prove unworkable or undesirable. We see no serious shortcomings in the present system which could not be corrected by additions or amendments to the present legislation.

We are concerned at the effect the reductions in incentives would have on the availability of capital to the oil industry which is, as you know, capital intensive now and will become even more so as exploration extends to the frontier areas of the north and offshore. We suggest it could lead, as many of the submissions have already indicated, to a serious cutback in exploration and development which might otherwise have been carried forward, and this at the very time when it has become evident that Canada needs additional petroleum and natural gas reserves which such programs could and would supply to meet expanding markets.

In particular, the proposals to eliminate or sharply curtail the depletion incentives available to the oil industry would worsen Cana-

da's already unfavourable competitive position with other countries, including the United States with regard to obtaining capital for exploration and development. While the United States recently reduced their gross allowances slightly, they still provide benefits substantially higher than those under the present Canadian system. This discrepancy, coupled with the generally lower tax rate prevailing in the United States and most other countries, puts Canada at a disadvantage in attracting capital.

Since 1947 Texaco Canada has paid \$160 million in income taxes. In 1969 the company absorbed against earnings \$15 million on federal and provincial income taxes and further payment to such governments for miscellaneous taxes, royalties, mineral rentals and lease bonuses of \$8.5 million, totalling \$23.5 million, equal to about 60 per cent of net income. This does not include several millions paid in municipal taxes and non-resident taxes on dividends and interest. In addition, federal sales taxes and provincial gasoline taxes collected from consumers exceeded \$175 million. In fact, for every \$1 of net income, the company's operations, produced more than \$8 for the federal and provincial governments. These statistics will explain our sensitivity to further increase in taxes which would come from the implementation of the White Paper proposals.

Turning now to the specific areas of great concern to Texaco Canada and our recommendations with respect thereto:

First, as to operator's depletion allowance. We recommend a depletion allowance of 25 per cent of gross income from oil and gas, after deducting royalty payments, limited to 50 per cent of net income after deducting production and exploration expenses. This would provide an incentive that would produce an effective tax rate reasonably competitive with that applicable to similar operations in the United States. The limitation would ensure that no depletion allowance would be available unless tax is payable.

For more than 20 years Texaco Canada has brought about development of oil and gas properties, both as a direct operator and through royalty farmout arrangements. Furthermore, the cancellation of this provision as proposed by the White Paper would be a form of severe retroactive taxation because it would presumably apply to prior agreements which are extremely difficult, under the present tax statute, to revise.

Third, we agree with the White Paper that an incentive should be provided to encourage Canadians to invest in equities of Canadian corporations. However, the proposals advanced by the White Paper would not do this in so far as resource industries are concerned and could have, in fact, the opposite effect. We prefer the retention and possibly the enlargement of the present system of dividend tax credits and shareholder depletion allowances. This would continue to provide an incentive for Canadians to invest in Canadian equities as well as provide a method of passing incentives through to the shareholders without penalizing them.

Fourth, the establishment of a category of "nothings" to permit their deduction over a period is indeed a welcome one although the 10 per cent diminishing balance rate is low for some items, for example, goodwill, considering that a recipient will incur immediate tax liability on amounts received from the sale of this item.

Fifth, we are pleased with the suggestion that certain corporations be given the right to be taxed as partnerships. We believe, however, that the restrictions proposed are somewhat harsher than necessary.

At this time I would like to bring to your attention a correction which should be made to our formal submission. The figure of 51.5 per cent at the end of the paragraph on page 12 should read 61.4 per cent. In the French text this appears at the end of line 1 on page 13.

Thank you, Mr. Chairman. With the assistance of the other members of our delegation, we will be pleased to try to answer any questions you may have concerning our submission.

The Acting Chairman: Mr. Farquharson, I see that you have given to us for distribution to honourable senators a comparison of the depletion allowances and the proposals to which you have referred, and their respective comparisons with the White Paper, the U.S., and the present system.

I am wondering whether one of the gentlemen—I do not know whether it would be Mr. Windrem or Mr. Fowler—would be good enough to pick up exhibit 1, please, and develop it with us a little more, or would you prefer to do it yourself, sir?

Mr. Farquharson: Thank you very much, Mr. Chairman. We appreciate this opportuni-

ty to come before you. I would ask Mr. Fowler to explain the charts.

The Acting Chairman: It is one of your basic suggestions and I think we should study it carefully.

Mr. K. O. Fowler, Assistant Tax Administrator, Texaco Canada Limited: Yes. The computation of the depletion allowances is not the easiest thing to follow, and we thought it would be worthwhile for all concerned if we went through the present system, what the White Paper proposes and what we propose, and, for comparison purposes, what the United States system now provides for. So, exhibit 1 is intended for this purpose. Exhibits 2 and 3 illustrate these in graphic form, that is, all but the U.S. systems.

First of all, the operators' depletion, which is the one that is of greatest concern to us as opposed to royalty depletion and shareholders' depletion—I do not want to downgrade royalty depletion—it is important—but operators' depletion is the most significant item to us as an operator.

For purposes of comparison, we have made certain assumptions here. In the example we assume a gross income of \$120, with lifting costs, direct drilling costs, picking the oil from the ground and marketing it of \$20. Item 3, drilling and exploration expenses of \$40, and item 4, bonuses of \$20. These are treated differently for income tax purposes at the present time, but drilling and exploration expenses are segregated for this purpose because they are treated differently in the White Paper proposals. We then have total expenses of \$80 which we subtract from the \$120 and it gives a net income of \$40.

Comparing the present systems, I turn to the present system which is one-third of net income. That is, the depletion allowance available under the present system is one-third of \$40, which is \$13.33 in our example.

Under the U.S. system, they allow a gross depletion allowance of 22 per cent computed on item 1, which is gross income, which is a total of \$26.40 in our example.

Senator Desruisseaux: Mr. Chairman, if I may interrupt, is that 22 per cent coming under review in the United States?

Mr. Fowler: That has been fixed after the review.

Senator Desruisseaux: After the review. Thank you.

Mr. Fowler: The former rate was 27½ per cent. The rate they settled on was 22 per cent. The 22 per cent is limited to 50 per cent of net income on a property-by-property basis. Here we are assuming that this is not limited but that under certain circumstances it could be. It is computed on the property-by-property basis as opposed to an over-all basis so that the results are not the same.

Under the White Paper proposals there are two elements involved. The operator will be allowed the lesser of the amount that is available under the present system or an amount calculated on expenditures incurred in drilling and exploration, being one-third of drilling and exploration expenses. That is, \$1 depletion would be permitted for each \$3 of drilling and exploration.

In the example we have here, the present system provides for \$13.33. The so-called earned depletion would also in this example be \$13.33, being one-third of item 3, that is, drilling and exploration expenses. So, in either case, the depletion would be \$13.33.

At this particular point the depletion allowance allowed in the White Paper proposal is a maximum allowance. In other words, if during exploration expenses were less, that would reduce it; if they were larger the net income would be reduced, so that in turn would reduce the other item.

Texaco's proposal is illustrated on the extreme right. There are two elements involved in our proposal as well. We are proposing the lesser of 25 per cent of gross, which is item 1, namely \$30, or 50 per cent of net income, which is item 5, or \$20. The lesser of these two, then, is \$20.

Are there any questions so far?

The Acting Chairman: Before questions are directed to you I should like to get the full picture. I notice you do not deal with the subject matter of tax holiday, nor do you deal with pre-development expenses and the like. Is it in the brief?

Mr. Fowler: No.

The Acting Chairman: Are you in favour of the continuance of the tax holiday?

Mr. Fowler: The tax holiday relates only to mining companies and mining operations. We have not addressed ourselves to that phase.

The Acting Chairman: I am directing myself to you because in the White Paper no distinction is drawn. We are dealing with tax

incentive companies generally, and I just wanted to get your thinking on it.

Mr. D. F. Bentley, Vice President and Legal Counsel, Texaco Canada Ltd.: Our position on this, as Mr. Fowler said, is that we have not dealt with this in our brief. We are aware that the mining industry has taken a very strong position on it, and we can see quite a bit of validity in their proposals. We have not directed ourselves to that. We could very well believe that they should be treated differently in view of what they have said, and we have no objection to their so doing from our point of view, although we are primarily, as you know, in the oil industry.

The Acting Chairman: But you would not regard the tax holiday granted to them as being discriminatory benefits, would you?

Mr. Bentley: Not as opposed to our oil industry, no, sir.

Senator Cook: Why is not the calculation for the United States limited to 50 per cent of the \$40 as you have done for Texaco? You show depletion at \$26.40. Should it be limited to \$20?

Mr. Fowler: It is limited on a property by property basis. If this was the only property they had and this was one property, you are quite correct, the limitation would then be \$20, provided all of the exploration expenses were incurred on that particular property. However, generally speaking most of the exploration expenses are not incurred on the property that is producing, though generally the limitation would not apply, certainly not to the same extent that it does under our present system or under our proposal.

Mr. O. C. Windrem, Tax Administrator, Texaco Canada Ltd.: I think it is fair to say that in the United States the limitation applies generally only when a property is being developed. Since the limitation is on a property by property basis, the net income is either zero or very small when they are doing their developing or exploration on the property. They look at each individual property as an entity and then determine the limitation on that basis, so if they have one or two years during development, let us say of a section of land or something in that category, that is when the limitation would apply, during that one- or two-year period as a general rule.

Senator Desruisseaux: What is the story on that in Canada?

Mr. Windrem: In Canada, as Mr. Fowler has explained, we are on a one-third of net income overall. As this exhibit shows, you take your gross income from oil and gas and deduct all your exploration and lease acquisition costs, all the costs associated with your exploration program. If you have any net income left you take one-third of that at the present time.

Senator Desruisseaux: Regardless of whether the property is being developed or not? What about other property on which you may have an allowance?

Mr. Windrem: You will not get an allowance unless you have net income. This is a misconception, I think, that is often held, that under the present law oil companies are getting depletion allowances and not paying any tax. The fact is that even under the present system you cannot get depletion allowance unless you pay tax.

Senator Everett: Did I understand you to say that the American restriction of 50 per cent on net income applies only in the first few years of the life of a property?

Mr. Windrem: I did not mean to imply that entirely. I meant that as a general rule that is the case. When you are developing a property you keep a P and L statement on that particular property by itself. Let us say you drill your first oil well and start to receive income from that well, if you continue drilling you will have no net income because the drilling will more than eat up the net income for that year, but the limitation is looked at on a year to year basis.

Senator Everett: That would indicate to me that the limitation would then apply after, not before.

Mr. Windrem: After?

Senator Everett: After you had finished your D and E.

Mr. Windrem: No. After you have finished your D and E, as a general rule your 50 per cent of net income is not a limitation, because the 22 per cent of gross, as it is at the present time—it was 27½ per cent—allowance is less than the 50 per cent net.

Senator Everett: Yes, I see.

Mr. Windrem: In other words, the limitation is to avoid a company getting depletion allowance when they have no net income on that particular property.

Senator Everett: What is the significance of limiting it to individual properties, as opposed to the Canadian system? Why do the Americans do that?

Mr. Windrem: I think perhaps it is the way their law was drawn up originally. They have always been on a property by property basis. Certainly it has a lot of merit. Looking at it on that basis, arriving at a limitation on an overall basis such as we have in Canada, it becomes difficult to arrive at a satisfactory limitation that does not have some kind of disincentive associated with it. In our proposals we explain why we think our suggestion overcomes this to some extent.

Senator Everett: Now we are talking about the depletion system based on a property by property basis, as opposed to one based on gross revenues.

Mr. Windrem: In the United States?

Senator Everett: No, I say that is what I am talking about. Where do you explain the advantage of one over the other. I have read your brief and I do not recall where that is.

Mr. Windrem: I think it would be desirable if we were to go on through these exhibits, and then if the question is still not answered we could answer it as that time. Would that be satisfactory? Or would you prefer to deal with it now?

Senator Everett: Only that it seems to refer specifically to item A—"The Americans have developed a property by property scheme". You are suggesting a lumping together. I think it is important that this committee find out why the Americans have suggested this scheme, because we have to make a recommendation. It may be that there is a great benefit to be derived from the property by property scheme, and therefore I would like to find out from you what are the benefits to the oil industry and the benefits to the government of the American scheme as opposed to the Canadian scheme.

Mr. Fowler: One obvious advantage to the system we propose is that we find that the property by property approach is administratively tremendous. I think this would be applicable both to the taxpayer and the tax collector, and we would like to see something that would accomplish pretty much the same thing in a much less difficult fashion. We think what we are proposing will do that. On an overall basis our understanding is that the

limitation that the United States system has does not reduce the gross depletion allowance significantly below that level. Perhaps it is one or two percentage points.

Senator Everett: I think that is far as we need to go, but I think, Mr. Chairman, we should make a reference to Mr. Gilmour on this because it is the first time that I knew there was a difference in the method of application as between here and the United States, that is a difference between applying the rules on a property by property basis as is done in the United States and on all overall basis as is done in Canada.

The Acting Chairman: And we should ask him to consider that from the point of his advice to the committee.

Senator Everett: Perhaps he could tell us more about it.

Mr. Bentley: If I might make it clear to the senator, we are not proposing a property by property basis in our submission today.

Senator Everett: I know that, but it is the first time that I have come across the fact that the American system is on a property by property basis, and I would like to find out more about it.

One other question; one of the problems of depletion, as you recommend it, seems to me to be that the less you spend on production and exploration, the more effective the depletion allowance is.

Mr. Windrem: That is not necessarily the case, I don't believe. The allowance that we have recommended will be based, as we have said, on about 25 per cent of gross income and limited to 50 per cent of the net from our oil and gas after deducting all our drilling and exploration and property acquisition costs and so on. The depletion would not be available unless tax was payable, and furthermore there would be no carry forward or depletion for deduction from subsequent income.

Senator Everett: There would no carry forward under your system?

Mr. Windrem: No, there would be no carry forward. You would only have the depletion if you had tax to pay. And if you didn't have tax to pay that year, there would be no depletion to carry forward.

Senator Everett: But if Texaco reduced their exploration program, the net income

from the production and operation would increase and they would get the benefit of the depletion allowance either way. By antithesis, if they maintain a high exploration program, they would not be able to take advantage of the depletion provision, and I think this is one of the things that the authors of the White Paper were trying to find a way to overcome. Shell Canada, when they were here, recommended a combination of the two, a gross income depletion and an earned depletion. This was combining the two so there was some incentive to continue exploration. I wonder what you think about that?

Mr. Fowler: I think we can explain it through another one of the exhibits we have here. Perhaps it would be appropriate at this time to look at exhibit number 2. Here we are comparing the depletion allowances under three proposals or under three systems. First of all, we have the present system, that is the solid black line there. Secondly, we have the White Paper proposals, which is the broken line and the third is the Texaco proposal which is the dotted line.

We are assuming a gross income again at 120, with lifting costs, and these are direct operating costs of 20. That then gives us an income, a net income before drilling or exploration expenditures of 100. Under the present system, if we spent nothing on exploration, we receive a depletion allowance of $33\frac{1}{3}$, which is $\frac{1}{3}$ of 100. Now at the other end of the scale, if we spend all our net income on drilling and exploration, we get no depletion allowance, so anywhere in between those two points the expenditure will determine the depletion available.

Looking at the White Paper proposals, the broken black line, we find that if you spend nothing on exploration, the limitation of \$1 for depletion for every \$3 of exploration comes into effect and you receive no depletion. We find that at 50, if you spend 50 per cent of your income on exploration, you maximize your depletion allowance under the White Paper proposals, and that, I believe, is $16\frac{2}{3}$. From that point on, the depletion declines as you increase your drilling and exploration expenditures because the present limitation will be carried on if the White Paper proposals are incorporated and take effect. There is one point that we should mention; in exhibit 1 we have indicated that expenditures on bonuses, which for most purposes are considered to be drilling and exploration expenses, except for the proposal

under the White Paper system, cannot be treated as drilling and exploration expenses for earned depletion. So the broken line below would shift to the right, reducing the depletion allowances available if that amount is spent on bonuses.

Looking at the Texaco proposal, we are proposing 25 per cent gross income, which is 30, and it remains constant until the point at which we spent in excess of 40 per cent of our net income on drilling and exploration expenditures, and at that point the 50 per cent limitation that we propose takes effect to reduce our depletion, and as we say, Senator Everett, beyond that point increases in drilling and exploration tend to reduce our depletion allowance.

Senator Everett: Perhaps I can interject here; under the present law, in the Texaco proposal there is no carry over, but under the White Paper, they do propose a carry-forward. Can you tell me whether that carry-forward has any effect on this graph, exhibit 2?

Mr. Windrem: Under the White Paper proposal you mean?

Senator Everett: Yes.

Mr. Fowler: There is a carry-forward of sorts. In any particular year, $33\frac{1}{3}$ limitation will always apply, but the earned depletion could be carried forward so that if in a subsequent year you had an insufficient earned depletion from work you did in that particular year it could be useful in bringing up to the present limitation.

Senator Everett: Under those circumstances if you were able to extend the graph and then bring the present effect of that graph back, the dotted line, with represents the White Paper proposal, might look better. In other words, it would invite the higher exploration.

Mr. Fowler: It would never be higher than the line as it appears here, but I do see your point.

Senator Everett: In other words, if you reduced your expenditure program, in 10 years time, say, the line would change, and if you were able to bring that line back to the year in question it would show a difference. I think that is why Shell made the dual proposal to take that into account.

Mr. Fowler: It would never exceed the present system even in the subsequent year.

Senator Everett: That is 33 per cent.

Mr. Fowler: Thirty-three per cent of the net.

Senator Everett: No, I am not disagreeing with you. I am agreeing with you, and you are quite right.

Mr. Bentley: You were wondering, Senator Everett, where this proposal was in our brief. It is summarized in the bottom paragraph on page 14 and at the top of page 15. It pretty well explains what we have said.

Senator Everett: I was not wondering where it was, Mr. Bentley. I thought one of you had stated that the difference between the American system of individual properties and the Canadian system was explained in the brief.

Mr. Bentley: No, it is not.

Mr. Fowler: I think perhaps exhibit 2 does not completely explain the point you raised. As we increase our drilling and exploration expenditures, there seems to be a disincentive because our depletion allowance is reduced, that is, beyond 40 per cent. Exhibit 3 helps to explain that. We have taken the three systems in Exhibit 3 and charged effective tax rates for each. The effective tax rates under the present system of course is $33\frac{1}{3}$ per cent and it remains constant.

Senator Everett: That is based on 50 per cent?

Mr. Fowler: Yes, on 50 per cent less one-third. Under the White Paper proposals it starts at 50 per cent, if you have no drilling exploration expenses, and declines to the point where you spend 50 per cent on eligible expenditures. Then it remains constant at 33 1/3 from that point on.

The proposal which we have made, assuming that the relationship of lifting cost to gross income is as we have indicated here—I feel it is a valid assumption—then the effective rate commences at 35, if you have no drilling and exploration expenses, and declines to 25 with the breaking point of 40 per cent of your drilling and exploration expenses. It remains constant at 25 per cent from that point on. In other words, we would never pay a tax rate lower on our producing operations than 25 per cent. It is true in absolute numbers that as our expenditures on drilling and exploration expense beyond the 40 per cent level increases, the depletion

allowance decreases, but so does our taxable income. I think that after a company has recovered essentially all of its costs, it should be willing to pay a lower rate of tax. I think 25 per cent is a reasonable one.

Mr. Windrem: If I could add to that and perhaps further answer your question, Senator Everett, as Mr. Fowler has explained we propose this system because it provides a lower effective tax rate that would make us more competitive with the United States. I think it has been stated before in this committee with regard to the United States experience that the U.S. oil companies have been very effective in finding oil and developing reserves, both within the United States and throughout the free world. I do not think there is any question that the depletion allowance in the United States has worked well and has provided the incentive required to develop oil reserves. We, in Canada, feel at this time that the need for capital is tremendous by comparison to what it has been in the past. In the past we have been carrying on conventional exploration in the Prairie regions of western Canada, primarily where the cost of doing that exploration was relatively small, being approximately one-fifth of what it would be in the Arctic and what it is off-shore and, in fact, today in the Arctic.

The amount of capital we are going to require in the next 10 years is perhaps double what it has been in the last 23 years, both to carry out the exploration and development as well as to provide the pipe line facilities which would get our crude oil to the markets, both in Canada and the United States, and perhaps elsewhere if we can develop sufficiently good reserves. It must be recognized that unless we have an effective incentive in Canada which will attract the necessary capital to this country, the capital will go elsewhere to develop oil reserves and it will supply the markets that may be available to Canada. The United States is the potential market we will have to look forward to.

As you know, discoveries have been made most recently in the North Sea. The United States has made major discoveries in Alaska and North Africa as well as South America. There are many places that may supply the oil which the United States needs. It is not only the United States that we need to talk about; it may be Canada's domestic needs for oil. If we do not have the incentive and we gradually start dwindling our reserves we may find that, instead of being self-sufficient in crude oil, we may have to look to imports.

This, I know, has been emphasized over and over again, the tremendous effect which being self-sufficient and becoming an exporter of crude oil has had on our foreign exchange position. These are all very important factors that are so often overlooked when you are talking about an incentive. When you are looking at an incentive versus perhaps a subsidy—we just do not agree with the idea of having subsidies. We think that subsidies tend to reward the unsuccessful or inefficient whereas incentives, such as the gross depletion allowances, would reward the successful and efficient operator without cost to the Government.

There is no direct off-the-top cost to the Government when you have an incentive. Let us say that 25 per cent of nothing is nothing. That is, if we do not have any net income we do not get any depletion allowance, whereas a subsidiary is a direct drain on Government revenue. In addition, if you have an effective incentive it may lead to economic growth and development in Canada, and this bill promote additional revenue to the Government in royalties, rentals and over-all income tax.

Senator Burchill: Mr. Chairman, our discussion for the last half hour or so has been based on tests that would make Canadian industries competitive with other industries such as in the United States. We have been talking entirely about taxation system,s but after all there are a great many other factors by which we can make Canadian industries competitive or non'pcompetitive with the United States.

I am thinking of the availability of natural products, the accessibility of natural products, the cost of operating expenses, and so on. Are these not all factors that enter into the whole proposition? This taxation is only one phase of it, is it not?

Mr. Fowler: Yes. Over-all economics is the important thing, that is true, but I do not think we have any significant advantage over the United States in other areas. They have the significant reserves, as we have, and in fact the only two very large oil fields in North America are in United States pools, one in Alaska and the other in Texas.

The others, I think, are comparable in size to ours. We have the additional disadvantage of distance from markets. I agree with you that there are many factors that have to be taken into account—the geological prospects and all

these things—but I do not think we have a significant advantage in other areas over the Americans, and we need to be competitive in the tax field as well.

The Acting Chairman: What Senator Burchill had in mind probably was that, in dealing with the subject matter of incentives, we must not only deal with taxation but also climatic conditions of Canada.

Senator Burchill: Yes. I am a natural producer, not of oil but of another natural product, and while taxation is one feature of it there are an awful lot of features I have to consider in order to get myself into a position to compete with my competitors.

The Acting Chairman: Have you made your point?

May I come back to exhibit 1 where you compare the present tax system in the second column with the proposed system of Texaco. The present tax is, of course, one-third of net income; that is, after deducting royalty expenses, lifting costs, drilling and exploration costs and bonus costs, and in the proposed Texaco system oyu have 25 per cent of gross after royalty expenses, limited to 50 per cent of net income.

I am not too clear as to what you mean by that. Does that mean that the other expenses referred to under the present set-up are deducted before you arrive at net income? Is there a variation in the determination of net income between the present system and the proposed Texaco system?

Mr. Fowler: No, it is exactly the same after deducting all your producing and exploration expenses.

The Acting Chairman: So there is no particular significance to the fact that you have not referred in the Texaco proposal to the same wording in the present system?

Mr. Fowler: No.

The Acting Chairman: I would not say it is an oversight. It is pretty clear when you are speaking of net income in the Texaco proposal that you compute this net income as computed presently.

Mr. Windrem: That is right.

The Acting Chairman: "As computed presently." I think we have to put that in, otherwise it is slightly confusing.

Mr. Windrem: I suppose what it means, Mr. Chairman, is that our recommendation is a limitation of 50 per cent of net income whereas the present system is one-third of net income.

The Acting Chairman: Yes, I see that.

Mr. Windrem: But we suggest that the gross depletion system with that limitation in it would provide us with more competitive...

The Acting Chairman: I realize that the question that Senator Everett asked about the Shell proposal may be embarrassing. Looking at it purely as citizens of the country, do you think that is a feasible suggestion to draw the distinction they have in mind compared to the one you are suggesting?

Mr. Windrem: Well, I do not know if it is really fair for us to comment.

The Acting Chairman: That is why I put it. If you prefer not to answer, that is perfectly all right. We are looking for guidance from people who are in the industry.

Mr. Windrem: We tend to look upon the so-called earned depletion system as a subsidy to some extent rather than an incentive, such as the gross depletion allowance is. The gross depletion allowance, a straight depletion allowance, a percentage depletion allowance, rewards the successful investor. It does not give anything to the people who spend a lot of money and are not successful. I think this is one of the important differences.

If I might add a little about the earned depletion system as proposed under the White Paper, there is no precedent for this type of depletion anywhere in the world. In France and in several other countries there is a so-called earned depletion which is based on a one-for-one reinvestment. Under the French system you claim a depletion currently and within a five-year period you have to reinvest that depletion allowance in exploration.

If you do not reinvest it within the five years, it is added back to income which, in effect, nullifies the depletion allowance.

Senator Everett: What is the depletion allowance?

Mr. Windrem: Well, there are various rates, of course, of depletion allowance. Do you mean in France?

Senator Everett: Yes.

Mr. Windrem: I understand that the depletion allowance in France is 27½ per cent of gross income, limited to 50 per cent of taxable income.

Senator Everett: To lose it you do not spend it within five years?

Mr. Windrem: Yes. If you do not spend the amount of the depletion. If you want to compare with what the White Paper proposes, they are saying three times the depletion you must spend in the same year.

Senator Everett: Do you like the French system?

Mr. Windrem: No, not particularly, but I think it is certainly a little more reasonable than what is proposed under the White Paper.

Senator Everett: It really is very similar to your suggestion except that it does have an added incentive, or disincentive—I am not sure what you would call it—that you must expend certain moneys in exploration.

Mr. Fowler: As a practical matter, a limitation of that sort is not likely to be a limitation at all, I would think.

Senator Beaubien: You are going to spend the money anyway.

Senator Everett: You mean exploration expenditures are higher?

Mr. Fowler: No. I suggest that if anybody does not spend at least that much over that period they must be going out of business.

The Acting Chairman: Your suggestion ex- the obligation to spend it in the five-year period is almost the same as the one you are suggesting; that is to say, the French rate of depletion, or computation of depletion, is similar to what you have suggested.

Mr. Windrem: The rate of depletion in France exceeds slightly what we are suggesting. I think.

The Acting Chairman: Did you not say that in France it is 2½ per cent of gross?

Mr. Windrem: Yes.

The Acting Chairman: You are suggesting 25 per cent?

Mr. Windrem: Yes, 25 per cent.

The Acting Chairman: In any event, not to exceed 50 per cent of net?

Mr. Windrem: Not to exceed 50 per cent of net.

The Acting Chairman: And not to exceed 50 per cent of net is part of the French system?

Mr. Windrem: That is right. I think we should point out that the limitation we have suggested would be more effective than we believe the French system is. Now, we are not experts on the French system.

Senator Cook: The White Paper proposals are, of course, designed to extract more tax from the industry. What effect do your proposals have on the yield, on the government take, as compared with what they get now, if any, and what they propose to get under the White Paper?

Mr. Windrem: Do you mean currently or in the long term?

Senator Cook: I think we should put in on the last fiscal year as far as we can. I do not mean your company only, but broadly speaking. Had the White Paper been in force from January 1, 1969, to January 31, 1969. I assume they would have taken more tax from the industry, and I am just wondering how much more. Have you any idea? Also, what effect would your proposal have on that suggestion of the treasury?

Mr. Fowler: We have made certain computations. Assuming that there would be no change in our program under the White Paper proposal—that is, we would have carried on in exactly the same fashion as we did and produce the same income—in 1969 our tax would have increased about \$1.3 million, which is 32 per cent on our producing operations; an increase of 32 per cent on our producing operations.

Senator Cook: Under the White Paper?

Mr. Fowler: Under the White Paper, yes. A good portion of that is from the cancellation of the depletion allowance on royalty income. Approximately \$450,000 tax would be involved on that item.

Mr. Farquharson: At this point perhaps we might comment on the proposal in the White Paper to delete the royalty depletion.

Senator Everett: Before you do that, I wonder if I could ask Mr. Farquharson what proportion of producing income Texaco is presently spending on exploration and development.

Mr. Farquharson: I think Mr. Fowler has a figure on that.

Mr. Fowler: During the past ten years we spent 69.2 per cent of our producing income on our exploration program.

Senator Everett: That is gross income or net?

Mr. Fowler: That is 69.2 per cent of our net operating income. That is our revenue from the sale of oil and gas less our direct operating costs. We spent below 69 per cent of what was remaining on our exploration program. This included bonus payments that we made to acquire acreage during the period.

Senator Cook: You say under the White Paper proposals your taxes are increased by 32 per cent approximately?

Mr. Fowler: This would be the increase on our producing operations in 1969.

Senator Cook: Had your proposals been in force instead of those of the White Paper, what effect would that have had on your tax bill?

Mr. Fowler: Our tax bill would have been reduced about \$½ million.

Senator Cook: From what it is now or under the White Paper?

Mr. Fowler: From the present basis.

The Acting Chairman: That is not too significant, is \$½ million?

Mr. Fowler: We paid \$4.1 million on our producing operations. Under our proposal we would have paid about \$3.6 million.

The Acting Chairman: Well, I suppose it is reasonably significant.

Senator Hollett: Are the bonus payments very high? Do you have to spend very much money on bonuses?

Mr. Fowler: They vary considerably from year to year, depending on the acreage that comes available. For example, in the last ten years our exploration expenditures were roughly \$48 million, of which about one-third was on the acquisition of acreage.

Senator Hollett: Mostly from the Government?

Mr. Fowler: Practically all from the Government.

Senator Cook: Going back to your proposal, are there any factors that make the position of Texaco very different from that of other companies in the oil industry?

Mr. Fowler: I do not suppose there is a typical company. I think circumstances vary from one company to another. I think we are not far out of line in proportion.

Senator Cook: Could I put the question this way, then. If the Texaco proposals were in force, would it tend to decrease the tax yield from the oil industry over the present system.

Mr. Fowler: We are quite satisfied that over the long term it would not. It would increase, because we feel the added incentive would be enough to produce the additional revenue, so this would not be the case.

Senator Cook: How long is long? At the present time, or 1969?

Mr. Fowler: I would not like to say how many there are, but there are not too many companies paying taxes at the present time, so it is very difficult to say. Under our proposal I think the limitation would indeed be affected—even in our operations they would be affected—so the 25 per cent rate that we are suggesting as a practical matter would be somewhat less, based on our projections for the next few years. If it were in effect, we think it would be perhaps in the order of 22 per cent. Whether this is typical of other companies it is difficult to say, but I believe it would indeed be an important factor.

Mr. Windrem: Further to your question, Senator Cook, asking how long is long, we might refer to the industry in the past 23 years, since the discovery of Leduc. The statistics indicate that the industry has spent \$14 billion or has invested \$14 billion in Canadian oil and gas exploration. During that same period, the industry, after 23 years, still has not as an industry complete payout. The payback at the present time is \$12.6 billion so that leaves a net deficit on a payout basis. Also during this same period there have been payments made to governments in Canada in excess of \$3.6 billion.

The Acting Chairman: That would be royalties and other types of taxes. But you are meeting squarely the problem we have to face in this committee. The opinion is expressed—why should an incentive industry

such as the oil industry think in terms of flowback of capital expenditures from the point of view of determining that that is something to which it is entitled. Other corporations spend fortunes on capital assets and speak of yield thereon in terms of profits on operations, you see. One appreciates the fact that in dealing with a risk industry such as yours, one cannot apply the normal rules that are applicable to non-risk industrial or commercial assets. We are all on common ground on that. Where we start our problem in dealing with the incentive industries is, having admitted that you are entitled to consideration, the issue still remains as to whether you should keep on getting depletion allowances that are not related to your profits.

Other segments of the economy are taking the position that surely somewhere down the line the issue is not a question of the reverse flow of capital expenditures but that having given you a reasonable amount of incentive, when does the industry as an industry start contributing to the current needs of the exchequer. That is a problem that this committee is facing. Therefore, we have no quarrel on incentives, but the real issue is whether there should be a continuance. In your plan here you are asking for a continuance. And whereas the White Paper speaks of reducing benefits, you are asking for an increase over the present provisions granted to you under the present law. In other words, instead of one-third of net income, you are asking for 25 per cent gross or 50 per cent of the net, whichever is the less. It is a little difficult for us to warrant a conclusion that the requirements of the country are such that—after all, the country is getting to be more and more settled and more and more industrialized; there is greater accessibility to oil supplies—admittedly as a result of your efforts and the efforts of the industry at large—but how high is up and how low is down in terms of incentive benefits?

Senator Cook: You mentioned the figure of \$14 billion which has not been repaid, or recouped, shall we say. It is the general conception that the oil companies are multi-millionaires taking all the money they can get out and not putting too much back. So that is an important figure to have. Having said that, I entirely agree with your summing up, Mr. Chairman.

The Acting Chairman: That is exactly the point. Other industries will put out \$14 billion on capital account and their success or failure

in operation is not related to the reverse flow on the \$14 billion on capital account within a reasonable period.

Senator Cook: But there is still a lot of oil in the ground representing that \$14 billion. The oil is still there. So that the \$14 billion is not gone. It will come back.

The Acting Chairman: That is right. One should face the issue squarely in dealing with the nature of the recommendations that we should make.

Senator Hollett: In your opinion, to what extent would the implementation of the White Paper affect your 3,500 employees? I know it is a difficult question, but you might have some ideas on that.

Mr. Bentley: As we have outlined in our brief, we feel that by imposing an increased tax on a good many of them, because they are, as you know, well paid—I think an example was given that a welder will make \$10,000 a year very easily—and we feel that by taxing him, possibly at an increased rate, and by making him subject to a capital gains tax on his investments because, remember, that many of these do invest either in shares of our company or in the shares of other companies under the very same plan, we feel the burden is going to be greater on him and he will have less incentive to save. There is no question that he will survive; we will all survive no matter what they do with the White Paper. But we think the conditions will not be as favourable as they were.

Mr. Chairman, I would like to return to the question that you posed, and that is the effect of depletion and why an industry requires it. As has been explained in many hearings, perhaps in the other place, the incentive allowances in Canada are now sort of built into the earnings of the companies, and the return of investment of the major oil companies at least in this country is certainly not very high in comparison with some other manufacturing industries. I think our own return investment is a little over 8 per cent. And I heard one of the other major companies say that theirs over a five-year period averaged out at 7 per cent. When you figure the cost of money today, we say we need this depletion allowance, and the industry needs this depletion allowance, and the proposal we make here is to enable us to generate and attract new capital necessary to meet the terrific demands that are to be faced in the future. Now I think Mr. Fowler has some statistics as to

what will have to be spent and how it will have to be spent over the next ten years.

The Acting Chairman: Yes, but, Mr. Bentley, before we get to that, as I say we are not getting into the arena of disagreement here.

Mr. Bentley: No, I understand that.

The Acting Chairman: But in dealing with your type of industry where you are dealing with the yield on the capital expenditure, that we are not dealing with the asset situation that is created as a result of a reasonable amount of discovery of oil in the ground, so that the question of yield on capital does not arise.

Mr. Bentley: Could I comment on the oil in the ground?

The Acting Chairman: Yes, but would you comment on the completion of my thought. I raised the question—at least I think I was the one who raised it, but I am not sure—that maybe the solution to this whole problem of the oil industry and the extractive industries generally is to say “here, we realize you are in a special category because of the circumstances. We will do away with depletion expenses; we will do away in the mining companies with tax holidays—but let us stick to oil—we will do away with depletion and all that sort of thing and we will give you a flat corporate rate of income tax. If the rate in Canada is 50 per cent, knowing the special circumstances, we won’t bother with royalty depletions or operators depletion and all that sort of thing, and we will say if the corporate rate in Canada is 50 per cent, how about half of that and go to work and find oil in the ground in Canada and be competitive to the rest of the world. We recognize you are in a special position.” Now I have completed my statement. How do you react to the overall situation?

Mr. Fowler: I think this is essentially what we are proposing.

The Acting Chairman: You are not proposing it in that form. You are relating it to gross income and a percentage of net income. I am taking an entirely different position, because I am not allowing depletion as an expense.

Mr. Windrem: Are you asking us what would happen if we had no depletion allowances?

The Acting Chairman: I am asking how would the industry react to the suggestion that we do away with depletion allowances completely as well as with royalty depletion. You can have your accountants prepare the necessary forms and we will cut your taxes in half.

Mr. Bentley: Our effective tax rate would be 25 per cent.

The Acting Chairman: On a 50 per cent rate.

Mr. Windrem: The chairman is suggesting, if I understand correctly, if the depletion allowances and royalty depletion were completely eliminated how would we react?

The Acting Chairman: To a flat rate of taxation lower than that applicable to all corporations other than incentive companies.

Mr. Fowler: I do not think there would be any objection from this quarter. If we are suggesting 25 per cent as being the absolute minimum which we would pay, the formula we are proposing could increase it anyway up to perhaps 35 per cent. The reason we are proposing it in this manner is that it would be competitive with the United States system.

The Acting Chairman: You are really developing the natural resources of our country and possibly you should be put in a special category of tax rate.

Senator Everett: What effective rate of tax is Texaco Canada paying now?

Mr. Windrem: Thirty-three and one-third per cent on our producing operations.

Senator Everett: Overall?

The Acting Chairman: You have got to relate it to the depletion.

Senator Everett: That, of course, obviously has to be 33½ per cent. I would still be interested in having an answer to my question as to the effective rate of tax to the whole corporation.

Mr. Fowler: If we take into account the bonus payments and royalties, and so on, which are unique to the oil industry...

Senator Everett: It comes down to net before taxes, does it not? It would be just an item from your financial statement.

Mr. Fowler: I think it is roughly 60 per cent if we take into account these other pay-

ments and treat them as taxes, because they are unique.

Senator Everett: We are talking about Crown sales.

Mr. Fowler: Yes.

Senator Everett: I am talking about income taxes.

Mr. Fowler: I have a series of numbers, but I am afraid I do not have that one.

Mr. Windrem: We can provide that information for you. I think the question really is: are we dealing with the incentives for the production and exploration part of the business rather than for our business as a whole.

Senator Everett: That is not the burden of my question, no.

Mr. Windrem: I realize that.

The Acting Chairman: Honourable senators, are there any further questions?

Mr. Farquharson: Could we have this royalty subject treated very briefly?

The Acting Chairman: You mean the royalty depletion?

Mr. Farquharson: That is right.

The Acting Chairman: Would you like to deal with it, Mr. Farquharson?

Mr. Farquharson: No, I will ask Mr. Windrem or Mr. Fowler to speak on it.

Mr. Fowler: Page 17 of our brief brings out our particular problem in connection with royalty depletion. It is especially important to us. I know it is important to other members of industry, but I think we have a different situation than existed for others. We had property some 20 years ago which we did spend exploration dollars on. We entered into a joint venture arrangement whereby both parties participated in its development. Due to a shortage of resources and primarily capital, and because we were not able to continue this system, we converted the arrangement to a royalty arrangement. It was not too long after that some significant discoveries were made, and we have been receiving royalty income on it ever since. As part of that particular arrangement we also became half owners of some other lands which we have participated in on an operating basis.

There was another feature to the agreement that permitted us to acquire a half interest in subsequent properties acquired by the other party. The royalty income has grown significantly over the period. In 1969 cancellation of the depletion allowance on the royalty income would have cost us \$450,000 in increased tax. Therefore, it is a matter of some concern to us.

Senator Everett: You view that as a retroactive taxation and, I think, quite justifiably so. When would that take place?

Mr. Windrem: Immediately.

Mr. Fowler: There is no indication that there is a transition period. Even if there was, it would still be retroactive unless there were provisions for the lands already committed to that particular arrangement to be excluded.

The Acting Chairman: Do you remember, Senator Everett, where we had a suggestion as to whether this royalty depletion should be allowed for the past, even though the White Paper does not wish to allow it at all? That is to say, there would be a cut-off for allowing depletion for existing agreements, but not for the future.

Senator Everett: I think we had two or three recommendations which were more general than that and concerned both depletion and royalty income. Whatever is done should not affect the present operations, but be applicable. They argued against it. They said if it was going to be, that it should be applicable for operations from this point forward so as not to constitute retroactive taxation.

The Acting Chairman: Speaking generally as distinguished from royalty depletion and covering broad ground, would it be feasible in computation of income and all the rest of it to have a cut-off situation with respect to a depletion set up based upon the old law and then a new system applicable for the future?

Mr. Farquharson: Are you speaking of royalties?

The Acting Chairman: Not royalties, but depletion as well.

Mr. Windrem: I am not sure I understand.

The Acting Chairman: Let us assume we allow depletion on the present system—not under the White Paper system—in respect to your activities to date and all your acquisi-

tions that have a new system applicable to the future.

Mr. Windrem: It would depend on what new system you had in mind.

The Acting Chairman: A new system. Is it feasible to consider two approaches to the depletion problem generally, not affecting royalty depletion allowance?

Mr. Fowler: Certain assumptions would have to be made, for example, to put the present properties on the same basis as they are at the moment, which have to carry exploration expenses. It would be difficult to determine which portion of such exploration expenses would normally apply to the present system as opposed to those which should apply to some future system. There would be difficulties here, but presumably rules could be provided.

The Acting Chairman: I think we would have the pig by the tail if we attempted that, even though Senator Everett said there were serious elements of retroactivity involved, particularly as we discussed previously, of bad faith. Investors bought securities based upon a year's projection of earnings, which was then the law and so forth. Everyone is reconciled to the change in corporate reports, but the investing public assumes more in terms of exploration by extraction companies.

Are there any other points you would like to put?

Senator Everett: I have one other question, Mr. Chairman, and that is on page 35. You say in the last paragraph that "it is imperative that Canada's personal and corporate taxes be competitive". We have done studies in the Senate Finance Committee which indicate that if Canada's personal and corporate taxes were competitive with those of the United States, due to the difference in the per capita efficiency of the two countries, there would be a fairly substantial short-fall and we would be in a position of serious deficit financing.

Now, perhaps part of the deficit could be taken up by a reduction in government spending, but I think even the most hard-headed efficiency expert would find it difficult to eliminate the deficit, and he would be forced to accept the fact that we would have to make up the difference by some form of taxation.

I agree wholeheartedly with the statement that you make earlier, but I am interested in

finding out what form of taxation you would propose to make up the difference. In that regard we have heard suggestions and have given consideration to the concept of value added taxes as a means of making up the differential.

Mr. Fowler: It is very difficult to develop a new system.

Senator Cook: The White Paper is finding that out.

Mr. Fowler: I think probably the problem is that our level of taxation in most fields is pretty well filled so that we would hope that at least over the long period we would tend to get closer in our total tax burden on a per capital basis or on a net income basis to the United States in order to improve our competitive position.

I think that as long as there is a wide discrepancy we will have extreme difficulty in keeping our best people and attracting industry to Canada to operate in a relatively high-class economy.

Senator Everett: Well, that indeed is the hope and it also raises the point that perhaps Canada's direct taxation should be less than that of the United States in order to spur the type of development that is necessary to raise the productivity of the average Canadian to the American level. But we still have that interregnum where we are going to be in a serious financial deficit position which, of course, would have the effect of severe inflation and all its consequent problems.

If you have not given any thought to that, we would be most pleased if you did so and let us have the benefit of your thought, since you raised the issue here.

Mr. Fowler: We do not have any suggestions. It is just our hope, as it is your hope, that these goals will be kept in mind and that programs will be trimmed in the future.

The Acting Chairman: I think Mr. Farquharson has indicated that they will look into this and give us the benefit of their thinking.

Senator Carter: May I ask, Senator Everett, when you referred to the short-fall in your comments, was that federal taxation or all taxation?

Senator Everett: This is all taxation.

Senator Carter: Of all provinces?

Senator Everett: All levels, yes.

Mr. Fowler: Does that take into account the increase in revenue, including that forecast by both the federal and Ontario Governments? There is some difference of opinion.

Senator Everett: No. This was prior to the White Paper and, indeed, was more concerned with the amount of income that was available for taxing purposes and the amount of taxes imposed on that income. But if it indicates that the measure of per capital of efficiency is below that of the United States, then clearly you are going to have to impose higher rates in order to bring it back up to their level, assuming our dollars are worth roughly the same as theirs.

Mr. Fowler: Unless we expand the tax base sufficiently.

Senator Everett: That is what I am asking you to look at. How do we expand that tax base? We have had some evidence on that and we are very interested in it because this is the logical alternative to maintaining an incentive, to satisfy our legitimate revenue needs.

Mr. Fowler: A healthy economic development is what we want, and to expand the tax base is basic, I think.

Senator Everett: We are most interested in the base.

Senator Cook: You make that point on page 32, the two paragraphs in the middle of the page which I think are excellent. I agree with every word that is said there. To my mind those two paragraphs sum up the whole thing.

The Acting Chairman: Thank you, gentlemen. We are grateful to you for coming here.

Mr. Farquharson: Thank you very much.

Honourable senators, the next presentation is by the Pension Fund Society of the Bank of Montreal, represented by Mr. S. A. Shepherd, Vice-President of Pension Plans, and Mr. M. Riddell, who is an investment counsellor.

First of all I want to apologize to you, gentlemen, for having you so late on the list today but we just have to have some order and there is always one at the end.

Will you start with your submission, please?

Mr. S. Shepherd, Vice-President, Pension Plans, the Pension Fund Society of the Bank of Montreal: Thank you, Mr. Chairman, for receiving us. In support of our submission, I am sorry that Mr. McLean, who was here this morning, is unable to be with us this afternoon. I am supported, however, by Mr. Michael Riddell of McLean, Baton Limited, Investment Managers and Consultants who are the investment counsellors for the Pension Fund Society of the Bank of Montreal.

My introductory remarks will be very brief, as the one-page outline in our submitted brief contains the gist of the society's representations. It should be commented, however, that the society has concentrated on one aspect only of the White Paper proposals, namely the third item in section 2.52 relating to the limitation on foreign investments of registered pension plans to 10 per cent of total assets.

The points discussed deal not only with the actual percentage limitation, but also with the method of application and the time period for implementation. This does not imply that other contents of the White Paper having application to the provision of pensions and the operation of pension plans have not attracted our attention and received constructive study. But these matters have been covered in briefs submitted by other bodies, in the preparation of which the bank and/or the Pension Fund Society have been interested, specifically those of the Canadian Pension Conference and the Canadian Banks Association. Because of the nature of these other briefs and the broader spectrum which they cover, the Pension Fund Society felt it would be worth while to, and indeed it should, deal in some great detail with this question of the limitation of foreign investments, which seemed to us of special significance in its effect on investment yields and pension plan costs and benefits.

The arguments are, of course, fully developed in the brief. If it is necessary to add further to this general comment, it would be to emphasize that it will be a happier situation if no percentage limitation at all were placed on foreign investments of pension funds, whether the seemingly arbitrary new proposal or the present restriction to 10 per cent of income. This will provide greater flexibility for the exercise of judgment and discretion in the use of the funds to the considered best long term advantage of those directly concerned.

Such is the trend of thought expressed in our recommendation that any percentage of assets limitation on foreign investments should not be less than 20 per cent.

To that I think I should add the underlined section which is the essence of our presentation:

We believe that the proposed 10 per cent foreign asset limitation is unduly restrictive. Bearing in mind that many pension funds have, as a short term objective, a proportion of assets in equities greater than 50 per cent, our recommendation is that an asset limitation, if indeed it is necessary, should be not less than 20 per cent.

Secondly:

If a percentage of assets foreign investment limitation is enacted, we believe that it should be calculated on the basis of original cost values of securities in portfolios.

Thirdly:

We believe a reasonable time period should be allowed to comply with a new foreign asset limitation and are in favour of a four-year period.

The Acting Chairman: Will you give us the reference back to the White Paper, Mr. Shepherd, so that we can read it with you?

Mr. Shepherd: It is section 2.52. It is quoted in Mr. Gilmour's review.

The Acting Chairman: I just want to get it from the White Paper proper. That is on page 22.

Senator Cook: It is 2.51, is it not?

Mr. Shepherd: Paragraph 2.51 is the introduction to it. Paragraph 2.52, the last item, is the one we are referring to.

The Acting Chairman: Would you read it?

Mr. Shepherd: It commences about two-thirds the way down the paragraph:

Third, in view of the size and rate of growth of pension and retirement savings funds, due in part to their tax-free status, it is reasonable to require that the bulk of them be productively invested in Canada. Consequently it is proposed that to qualify for the tax-free status of registered pension plans or registered retire-

ment savings plans, these plans must invest no more than 10 per cent of their assets in foreign securities or other investments.

The Acting Chairman: Can you guide us? I have a bit of a blind spot on this one. Are there any other sections in the White Paper which restrict the investing public in Canada in respect of the acquisition of foreign securities? I know there is the question of the tax-free status, but I do not recollect any as such.

Mr. M. Riddell (Outside Investment Counsellor, The Pension Fund Society of The Bank of Montreal): There are certain incentives which make it more desirable to hold Canadian securities perhaps, but no firm restriction.

The Acting Chairman: So is this the only instance in the White Paper where there is a specific restriction on the proposed legal right to acquire foreign securities or other foreign investments?

Mr. Riddell: To the best of my knowledge, Mr. Chairman.

The Acting Chairman: That is what I thought, because I could not think of any other instance in the White Paper.

Mr. Shepherd: There is a present restriction, as you know, limiting the investments to 10 per cent of income. In other words, no more than 10 per cent of the income of a pension plan may be obtained from foreign sources, as long as it is a registered plan, and subject to a tax exemption, or tax-free status.

Senator Burchill: Are there any restrictions at the present time on the amount of foreign investments for pension funds?

Mr. Shepherd: Only with respect to the limitation on the percentage of income that may be acquired from foreign sources, which is 10 per cent of income. As long as we keep within the 10 per cent range, the percentage of actual capital investment, principal investment, is not limited. In fact, it has gone up as high, in our case, as 23 per cent of market value; somewhat less in terms of cost value, but well in excess of the 10 per cent which it is now proposed to impose.

The Acting Chairman: Of course, this brings us head on to a development of the Canadian climate, going to the subject matter of the use of our available capital for investment in Canada, does it not?

Mr. Shepherd: That is correct, sir.

The Acting Chairman: You would know that pretty well because of your connection with the B of M and so on. What sound position could we take against a suggestion of this kind?

Mr. Shepherd: Well, I made a few notes last night in anticipation of some questions of this kind. These are reasons in favour of having no limitation on foreign investments as such, or for an increased limit over that proposed of 10 per cent, including even a continuation of the present limit, if that is necessary.

(1) Give the trustees a free hand in doing the best possible for the parties concerned. That is, to maximize the yield over the long term to the end of reducing costs or increasing benefits.

(2) Not to place impediments in the way of optimum free flow of capital internationally. Restrictions often invite retaliation.

(3) Under the present restrictions not many funds have in fact exceeded the proposed 10 per cent figure, but a number have done so in an endeavour to take full advantage permitted of growth possibilities in foreign equities. This indicates that pension funds as a whole may be expected to act rationally in the light of their best judgment, and argues against the need for a limit.

(4) Limited opportunity for inequity investment in growth industries in Canada exist, and thus in some instances, the only way to get an interest in Canadian growth is by investment in foreign parent companies having Canadian subsidiaries. I have heard it suggested, Mr. Chairman, that if a limit is imposed, perhaps investments in foreign parent companies having substantial Canadian subsidiaries should be regarded for this purpose as Canadian.

(5) It would lead to juggling in purchases and sales of investments in Canadian and foreign investments often at inopportune times in order to bring proportions into line either now or later. For example, it would lead to forced losses which would have to be taken which otherwise would not be. It would lead to a problem with respect of the taking of profits on sales of foreign investments which otherwise might seem desirable from time to time, which would build the profit taken into the new cost base of the new investments in the foreign area. In other

words, I think it is one of the proposals or one of the suggestions that this 10 per cent figure be based on cost values rather than market values. That would, as I say, handicap or create problems where sales took place abroad to realize a market profit, and, if that money were reinvested abroad, in effect the profit would be built into the new cost price of the new investment.

(6) An inability to invest to full advantage if the result is to reduce yields either because of unavailability or because of overpriced Canadian stocks. That would tend to discourage savings in the form of pension plans.

(7) If investment in foreign stocks results in higher long-term returns with lower costs or enhanced benefits for Canadians, why should we not let the foreign country in effect pay for part of our pensions, or for better pensions. The point there is that if the yields are higher abroad, we are investing in a foreign economy where the growth is greater than our own, perhaps, at a particular time, and their economy is paying for part of our pensions.

(8) For those plans having members abroad, a type of restriction might invite those plans to slough off their foreign membership in a separate foreign plan with the withdrawal of any advantage that Canada might be open to receive through foreign income and foreign contributions. This, I think, is probably a little thin, but it is a point.

(9) If forced into Canadian fixed income investments by lack of Canadian growth equities or too high a price, a situation such as that entered into voluntarily in earlier years might be encountered in time, that is the infliction on pension funds of relatively low yielding long-term fixed income investments. Perhaps I should say there, Mr. Chairman, that the thought there and elsewhere is that if pension plans are to be limited to investments in Canada or to having a very high percentage of their assets in Canada, that would create a demand—and this is developed in the brief—a strong demand for Canadian equities forcing prices up and actual yields down over the long term.

(10) A better diversification by investment abroad would reduce risk inherent in the high concentration of investment in Canada which would probably result.

(11) The figure of 10 per cent seems to us to have no particular merit or rationalization

and we wonder why it should be 10 per cent of assets as against the present 10 per cent of income. It is a greater restriction than that which presently exists. Why should it not be nil or why should it not be 50 per cent? We are not able to rationalize the figure of 10 per cent.

In a word, we feel that there is no valid or rational argument for a limitation as opposed to those arguments in favour of a free hand, particularly in figures such as 10 per cent, and such a restriction would harm the interests of those interested in pension plans without necessarily benefiting the country as a whole.

The Acting Chairman: That is a very impressive list of reasons. Have you the exact wording of the Income Tax Act with respect to the limitation on income? Because in direct answer to your question, I would think that the 10 per cent mentioned there on yield—they thought they may as well put in a limitation of 10 per cent on capital assets. At least I would have thought so.

Mr. Shepherd: I am reminded that the reference is really the other way around—rather than 10 per cent, the reference is to the fact that the investment must be at least 90 per cent in Canada.

The Acting Chairman: That is right, and I suppose you would agree that in order to get tax-free status, there would be a reaction if, say, 100 per cent were invested in foreign securities or other foreign investments. I am just trying to answer your question.

Mr. Shepherd: I think there would be a reaction, sir.

The Acting Chairman: Ten per cent is not a rational figure. One hundred per cent would be equally troublesome the other way.

Mr. Shepherd: It would if the majority of pension plans took that action, but it would not necessarily follow. I would refer the committee to section 62(1)(q).

The Acting Chairman: Section 62(1)(q). I think that should be read into the record because honourable senators will be studying this in due course. We have to relate the suggestions in the White Paper to the existing law.

Honourable senators, Mr. Shepherd is going to read from the Income Tax Act. Please read the pertinent section with respect to the 10 per cent restriction.

Mr. Shepherd:

(Exemptions).—(1)

No tax is payable under this Part upon the taxable income of a person for a period when that person was...

Then it goes on to subsection (q):

Pension trust or corporation—a trust or corporation established or incorporated solely in connection with, or for the administration of, a registered pension fund or plan, not less than 90 per cent of the income of which for the period was

(i) from sources in Canada,

(ii) from bonds, debentures or other securities issued or guaranteed by

(A) the International Bank for Reconstruction and Development established by the Agreement for an International Bank for Reconstruction and Development approved by subsection (1) of section 2 of the *Bretton Woods Agreement Act*, or

(B) the Inter-American Development Bank, the income from which securities is payable in Canadian currency, or

(iii) from sources in Canada and from bonds, debentures or other securities described in subparagraph (ii);

The Acting Chairman: The reconstruction and that sort of thing is simply to encourage investment in the international agencies to assimilate it to Canadian income. I think we have the record clear. Are there any questions on this point?

I think in the final analysis we will have to consider these representations in relationship to this overall question of the use of Canadian savings for the expansion of Canadian industry and to what extent there should be tax exemptions even though the tax-free income is used outside of Canada. The headings which you have used are very important and if I may say so very impressive.

Senator Isnor: What percentage of your pension fund is created by employees in Canada?

The Acting Chairman: This is the pension fund of the Bank of Montreal which they are speaking about now.

Mr. Shepherd: We have employees outside of Canada who are not members of the fund. It would be certainly 98 per cent in Canada, but that is a very rough figure.

Senator Isnor: I do not see why those who are contributing to the pension fund should not invest their own money in Canada where they earn it. That is why I ask the question.

Mr. Shepherd: We try to argue that that should not necessarily be the case, sir.

Senator Isnor: That is a different view than yours, Mr. Chairman.

Senator Haig: Mr. Shepherd, when an employee of the Bank of Montreal invests in this fund and retires, how is the money taken out, as a lump sum or as an annuity?

Mr. Shepherd: In the form of an annuity, a pension. There is no lump sum payment.

Senator Haig: This section does not apply; a savings withdrawn from these plans would be taxed at ordinary rates. The man is just taxed on his pensionable annuities.

Mr. Shepherd: He is taxed on his pension as he receives it.

Senator Haig: The pension is determined actuarially on the length of service. Does the bank contribute to this fund?

Mr. Shepherd: The bank contributes very substantially, yes.

Senator Haig: You have one fund started in...

Mr. Shepherd: We have now a second Pension Fund Society of the Bank of Montreal which was set up to take care of the female employees who were not members of the Pension Fund Society before 1967. We had a retiring allowance arrangement and a pay-as-you-go arrangement which could no longer be continued under the present Standards Act. We had to establish a formal funded plan whether we wished to or not. That is the reason for establishing the second society.

Senator Haig: You cannot be members of both, can you?

Mr. Shepherd: No, sir. The male clerical and managerial employees of the bank are and always have been members of the first pension fund, the old Pension Fund Society which goes back to 1884. The retiring allowances were paid on a prescribed formula to female employees and some other employees not in the clerical or managerial group. It is those people who did not have an formal plan previously who now have a formal plan in the form and shape of the second Pension Fund Society.

Senator Haig: Is this pension fund compulsory?

Mr. Shepherd: It is, sir.

Senator Cook: Mr. Shepherd, do you know if the Bank of Montreal pension fund is alone in its opposition to this restriction, or do other pension funds share your view?

Mr. Shepherd: There are other pension funds that share our view. There are a number of pension plans, to my knowledge, that have investments abroad at the present time in excess of the 10 per cent proposed limit, but within the 10 per cent present income limit.

The matter has been covered in the brief of the Canadian Pension Conference among other things related to pension plans in general, but, as I indicated, we thought this was a point which could be expanded upon in the form of our brief here which goes into considerable detail as to the effects of this proposal on the situation of pension plans and the effect on benefits and costs in restricting investment in this way to Canada.

Senator Cook: So your main object, of course, is, as far as possible, to increase the benefits to the pensioners with as much security as possible.

Mr. Shepherd: Well, that is it. It works two ways. You can either reduce the costs to the employees and the employer and therefore reduce the costs in Canada and in the general economy or, from the additional income, additional benefits could be paid.

The Acting Chairman: I would like to put a question to Mr. Shepherd, if I may, to get the benefit of expertise here, free of charge. Mr. Shepherd, suppose you regulate your investments in such a way that the income from foreign sources will not exceed 10 per cent, and suppose these foreign companies by way of bonuses or bonanzas or special benefits bring in, in a given year, a situation where your income is in excess of 10 per cent. Are you penalized only to the extent of that in excess or do you lose your status for the year or permanently, and do you have to re-register?

Mr. Shepherd: As I understand it, we lose our status permanently. We would lose the tax exemption. This is a matter which has given us concern that is, under the 10 per cent income restriction, of having to keep well within that. We keep running a month-

by-month record of the dividends received, but the investments are also dispersed to the extent that if one or two companies pay a substantial bonus for the year, we would still not run over the 10 per cent.

The Acting Chairman: But if you had these foreign corporations really pulling off a bonanza by capitalization of surpluses, you could get into trouble.

Mr. Shepherd: Yes, sir, we could get into trouble.

Senator Burchill: I was going to ask you, Mr. Chairman, if we had any similar contribution from any other companies or any other pension societies?

The Acting Chairman: I am sorry. I do not recollect the subject matter being dealt with before, as far as I can remember.

Senator Molson: Retirement savings plans already had a strong brief on the changes proposed in the White Paper.

The Acting Chairman: This is a different point.

Senator Molson: A completely different point.

Senator Molson: Nothing from a pension plan or from a foreign society.

Mr. Shepherd: Mr. Chairman, I think there was before you, on April 8, the William M. Mercer Limited, and while this point was not included in their brief it did come up in discussion in your committee. They were speaking, of course, for a group of pension plans and criticized this 10 per cent limitation, and also expressed the view that they would prefer there would be no limit of this kind at all.

The Acting Chairman: It certainly has escaped us if it took place before.

Senator Carter: How much is paid in Canada in total into trustee pension plans?

Mr. Shepherd: Into trustee pension plans?

Mr. Riddell: It is close to a billion dollars, I think.

Senator Carter: Each year?

Mr. Shepherd: Last year, yes.

Senator Carter: You are faced with the problem of inverting that billion dollars in profitable Canadian companies.

Mr. Shepherd: One would be if restricted only to Canada.

Senator Cook: Was not some of the billion dollars paid back in pensions?

Mr. Shepherd: This is an increase in assets I am referring to. It is something else. It is \$1 billion, but the figure is there.

Mr. Riddell: Yes, senator. The latest figure available is for 1968. The total paid in was \$863 million in 1968.

The Acting Chairman: And to answer Senator Cook's point, what was paid out?

Mr. Riddell: Well, \$295 million was paid out.

Senator Carter: Roughly about \$600 million left.

Mr. Riddell: Yes. I am sorry there an important addition in terms of income from investments of \$429 million, so you have total revenue in 1968 in the trustee pension plan of \$1,300,000. Therefore you have pension payments out of \$295 million and other sundry payments, cash withdrawals, et cetera, of \$425 million. So you really do have a net amount to be invested in the order of \$900 million.

The Acting Chairman: So, Mr. Shepherd was right when he said close to \$1 billion.

Senator Carter: The White Paper as prepared insists you invest 90 per cent of acting Canadian equity.

Senator Cook: Not Canadian equity.

Mr. Shepherd: No, Canadian investments.

Senator Carter: There are two alternatives—one is to reduce costs and the other is to increase benefits, according to your statement. In your brief you refer to the cost factor for management and to the increasingly important factor in the cost of running a business as an operation cost. Which of these two alternatives is the more likely?

Mr. Shepherd: I think that it is impossible for me to say, senator. This is a matter of judgment and individual treatment and also of the relations with employees, as to which is the most favoured approach in the individual case.

Senator Carter: Are the negotiations participated in by the employees?

Mr. Shepherd: In the case of negotiating plans with unions, it is to some extent made by employees. Many pension plans are negotiated with employers and employees as part of the whole agreement. So I do not think one can be categorical in saying which way the thing will work out, either by reduction in cost or increase in benefits.

Senator Isnor: Are the employees represented on the board?

Mr. Shepherd: Are the employees, as employees, represented on the management board of pension plans?

Senator Isnor: Yes.

Mr. Shepherd: All the officers administering for the trustees of the pension plans are employees of the plant.

Senator Carter: While on this point, we had a witness before us some time ago who made a suggestion to create an incentive to invest in municipal bonds. I do not know if you remember that, Mr. Chairman.

The Acting Chairman: Yes.

Senator Carter: I wonder if that would help solve the problem, if we tried an incentive.

The Acting Chairman: I think I would like to explain this. This came from one of the gentlemen representing the Investment Dealers Association of Canada—I think it was Mr. Dinnick, the president. The suggestion was that income resulting from the purchase of municipal and provincial bonds, up to \$1,000, be not included in the taxable income of the recipient of such interest or dividend. I think Senator Carter is asking you whether you would regard that as an interesting and attractive suggestion.

Mr. Shepherd: As far as pension plans are concerned, we do not pay income tax now on the interest and dividends—is that the point?

The Acting Chairman: Yes.

Mr. Shepherd: Except that it would make no difference.

The Acting Chairman: It would not make any difference, as you see, Senator Carter, because as long as 90 per cent of the income is from Canadian sources as defined under section 61 of the act, then it being exempt, the problem does not arise.

Senator Carter: I see.

The Acting Chairman: But I think it is a very exciting situation, if I may say so as a tax lawyer, to find a situation of this sort, where due to circumstances over which you have no control, you can be investing fortunes and then lose tax exemption because of the acts of third parties over which you had no control, and in that way bringing about serious consequences. If you are investing in a

given year a billion dollars, to take only one year, at 6 per cent, \$60 million, and then you get your tax rate on it because some of the bonanzas have turned up within a restricted area of 10 per cent of income it is a fantastic situation that could arise, theoretically.

Are there any other questions? If not, we thank you, Mr. Shepherd.

The committee adjourned.

APPENDIX "A"

Canadian International Power Company Limited

SUBMISSION TO

THE STANDING SENATE COMMITTEE ON
BANKING, TRADE AND COMMERCE
THE SENATE
OTTAWA, ONTARIO

AND

THE STANDING COMMITTEE ON FINANCE
TRADE AND ECONOMIC AFFAIRS
HOUSE OF COMMONS
OTTAWA, ONTARIO

IN THE MATTER OF PROPOSALS
FOR TAX REFORM, 1969.

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SUBMISSION

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APPENDIX "A"

SUBMISSION

TO:

STANDING SENATE COMMITTEE ON
BANKING, TRADE AND COMMERCE,
THE SENATE,
OTTAWA, ONTARIO

AND

STANDING COMMITTEE ON FINANCE,
TRADE AND ECONOMIC AFFAIRS,
HOUSE OF COMMONS,
OTTAWA, ONTARIO

Sirs:

The undersigned, CANADIAN INTERNATIONAL
POWER COMPANY LIMITED, 276 St. James Street West,
Montreal, P.Q. in response to your invitation to the
taxpayers of Canada to make representations with respect
to the implementation of the recommendations of the
"White Paper Proposals for Tax Reform, 1969", submits
the following brief.

John Kazakoff - President
April 2, 1970

BACKGROUND AND SUMMARY

Canadian International Power Company Limited (C I Power), a publicly-held Canadian corporation whose shares are listed on the Montreal and American Stock Exchanges, is a taxable corporation which has a "degree of Canadian ownership" of its outstanding shares as defined in the Income Tax Act, s.139A. The total book value of its assets is approximately \$210,000,000 and its consolidated net income for 1969 was approximately \$13,530,000.

The present C I Power System dates back to the formation of International Power Company Limited in 1926. At that time, International Power acquired a number of operating utility companies in Latin America, some of which had been formed a number of years previously (the Mexican operation, to this day a Canadian company, was formed in 1905, and the Venezuelan operation dates back to before 1900). In 1956, a corporate reorganization resulted in the formation of Canadian International Power Company Limited, of which International Power Company became a subsidiary.

Substantially all of C I Power's operations are conducted outside Canada. The operations consist primarily of the construction, operation and supervision of thermal-electric and hydro-electric power plants and the transmission and distribution of electric power, in Venezuela, El Salvador, Barbados and Bolivia. Former electric utility installations in Mexico were purchased by an agency of the Mexican Government by forced realization in 1962. C I Power now holds both controlling and minority interests in industrial companies in that country.

C I Power's operations in Venezuela, El Salvador and Barbados are conducted through subsidiaries (or Sub-subsidiaries) incorporated in those countries. The

operations in Mexico are conducted by Mexican companies which are subsidiaries of Monterey Railway, Light and Power Company, a Canadian company which in turn is a subsidiary of C I Power.

The operations in Bolivia are conducted by Bolivian Power Company Limited, a Nova Scotia company which is a subsidiary of C I Power.

Monterey Railway, Light and Power Company and Bolivian Power Company Limited are both foreign business corporations under s.71 of the Income Tax Act. Bolivian Power Company Limited conducts its operations in Bolivia directly, and Monterey Railway, Light and Power Company operates in Mexico through subsidiaries.

International Power Company Limited, another Canadian subsidiary of C I Power, is also a foreign business corporation and operates through subsidiaries in Venezuela, Bolivia and Mexico.

Further details showing the structure and shareholdings of the companies within the C I Power System are shown on Appendix "A" hereto.

It can be seen from the foregoing that the C I Power System is affected by most of the aspects of taxation which are dealt with in the International Section of the "White Paper" Proposals:

1. C I Power itself is a widely-held Canadian corporation subject to normal Canadian taxes;
2. It has three subsidiaries incorporated in Canada which are "foreign business corporations", one operating directly abroad and the other two

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operating abroad through locally-incorporated operating subsidiaries; and

3. It has directly-owned subsidiaries (or sub-subsidiaries) which are incorporated in the countries in which they operate.

C I Power and its subsidiaries are therefore in substantially the same position with respect to taxation as are various other large corporate complexes whose head office operations are conducted from within Canada.

The C I Power System has conducted its international business operations from Canada for over 44 years, primarily because the laws of Canada have continually presented a favourable climate for the attraction of capital investments and the fulfilment of obligations to investors and customers.

It has been many years since C I Power has raised new capital in Canada. Expansion programs and modernization of services to customers have been financed through retained earnings in the various operating subsidiaries, and access to international capital markets.

Moreover, C I Power received substantial net dollar amounts of foreign exchange through dividends from subsidiaries; it contributes further to the Canadian economy by having its independent professional engineering services provided by Canadian engineers employed in or from Canada, by having its financial and administrative services provided within Canada, and by purchasing substantial quantities of equipment and supplies in Canada for the operating subsidiaries; these facts plus the fact that the operations of the subsidiaries materially enhance the Canadian image in the foreign countries concerned, make C I Power and its subsidiaries a total "plus" to the

Canadian economy.

The International Section of the "Proposals for Tax Reform, 1969" (the "White Paper") states in paragraph 6.2 that "the Canadian tax treatment of the foreign income of Canadians does not seek to discourage Canadians from investing or carrying on business abroad". We believe, however, that the collective impact of the "Proposals" is such that the value of our foreign investments would be substantially reduced and our ability to continue to serve the expanding needs of our customers, while providing a fair return to our shareholders, would be substantially impaired if our organization were to remain in Canada.

Canada's concern for conditions and events in all parts of the world has continually characterized this country's international relations. We respectfully submit that the effect of the "White Paper's" proposals is contrary to this tradition.

Meanwhile it should be said that the actual issue for C I Power is whether, in the event that the "Proposals" are implemented, it will be possible or feasible for the direction of the C I Power System to continue in Canada.

This decision is not solely for the C I Power administration and its Canadian shareholders because approximately 62% of its shares are held outside of Canada.

The loss to Canada of this foreign investment in C I Power or even a substantial part of it, would obviously be a serious matter.

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C I Power's concern is primarily with the following "White Paper" Proposals:

It proposes to tax dividends received from a foreign subsidiary operating in a country with which there is no treaty; such dividends are presently exempt under s.28(d).

It proposes to tax the entire income of a foreign branch operation while taxing only actual dividends received from a foreign subsidiary; such foreign branch income is presently exempt under s.71.

It proposes to tax the entire gains on the sale of shares of foreign corporations but only 50% of the gain on the sale of widely-held Canadian corporations; no part of either type of gain is presently taxed.

It proposes to tax periodically appreciation in value of shares of widely-held Canadian corporations even if such gain has not been realized and even if there are no funds with which to pay such tax.

It proposes to tax to the parent the passive income of a foreign subsidiary even if not remitted and without regard to the circumstance under which the passive income arose; no undistributed income of a subsidiary is presently taxed to its parent.

The "Proposals" add to the circumstances under which foreign source income is subjected to Canadian tax while ignoring source country restrictions on use and repatriation of such income.

The "Proposals" do not distinguish adequately between direct investment in developing countries and other types and areas of investment.

It proposes to grant a larger dividend credit to shareholders of Canadian corporations operating solely in Canada than to shareholders of Canadian corporations operating outside Canada, either directly or through foreign subsidiaries; both categories of shareholders presently are given the same credit under s.38.

We shall discuss each of the foregoing and other specific points in detail in paragraphs 1 to 18 inclusive below and in those respective paragraphs we shall make alternative proposals where they seem to be indicated.

INVESTMENT BY CANADIANS IN FOREIGN COUNTRIES

Canada's role on the international scene has, from its very beginning, been marked with distinction. The remarkable inflow of capital and technology to develop its resources as well as its non-discriminatory open door policy on immigration has made Canada particularly sensitive to the needs of other nations in the process of development.

Since World War II, Canada's sense of responsibility toward the world community has been evidenced by our major contribution to the Colombo Plan, selective economic aid to many developing countries and active participation in innumerable international conferences and agencies on economic and social issues.

We believe that Canada should continue to recognize the special situation of the developing nations and encourage capital and technological transfers of a selective nature. The report of the Commission on International Development, headed by the Hon. Lester B. Pearson, Nobel Prize winner in 1957, entitled "Partners in Development" and submitted recently to the World Bank, contains many references to the moral obligation of the industrialized countries towards the less developed nations. It recommends a capital transfer via private or international multi-lateral channels of 1% of Gross National Product of the developed countries per annum. Canada's record in this respect has not reached the above figure in recent years (0.49% in 1968) and the increased tax burden on international income implicit in the "White Paper" combined with the explicit encouragement of investment in

Canada at the expense even of bona fide foreign direct investment will further reduce the flow of capital exports. We believe it is not the intention of either the "White Paper" or the people of Canada to discourage or impede the strengthening of economic ties with developing countries.

In emphasizing special consideration for the developing countries and the preservation of their right to attract capital through the use of tax incentives, we make a special plea on behalf of the developing nations of Latin America. For many obvious reasons, not the least being hemispheric solidarity, Latin America should have a privileged claim to Canada's preferential treatment. The amount of Canadian investment in Latin America is relatively small, being but 5.8% of the total foreign direct investment (DBS 1967). The recent establishment of the Canadian Association for Latin America, in which C I Power has played a leading role, indicates the interest of Canadian businesses in fostering and expanding their relation and trade with Latin America.

Canada's contribution to the economic growth of the developing countries would be jeopardized if the discrimination implicit in the tax proposals against foreign-source income becomes legislation. The "White Paper" does not adequately distinguish between capital transfers to the developing nations and other parts of the world. The elimination of barriers to the transfer of capital and technology from the developed nations to the developing nations was strongly recommended by the Pearson Report. Canadian multi-national firms are important and useful conduits for such transfers.

We believe that Canada has a major stake in

promoting the elimination of impediments of all kinds to the free international movement of capital and should maintain its ability to oppose effectively the adoption of any such impediments by other countries. Discrimination through our tax system in favour of domestic investment will weaken our ability to resist discrimination by other countries that would affect Canada's attractiveness to foreign investment.

We believe that private overseas investment has brought distinction to Canada in many tangible and intangible ways, but also and equally important it makes a contribution economically to the country. We can put forward without hesitation our own company to bear scrutiny on both counts. Over a forty-year period of participation in the development of the electric power industry of Latin America, and in even the most difficult periods of political stress, the company has always managed to retain the confidence of the public authorities in the countries where it serves. At the same time, the company's contribution economically to Canada has always been a positive one in terms of the exports its activities generate and in the flow of capital funds.

C I Power contributes a great deal to Canada. Since 1956, C I Power has paid out to its shareholders over \$40,900,000 in cash dividends. Of this, approximately \$26,900,000 was paid to Canadian shareholders and taxed at their progressive tax rates; the balance was subject to the withholding tax amounting to approximately \$1,700,000 on dividends paid to non-residents. During the last seven years, C I Power has made purchases in Canada totalling over \$6,500,000 and has paid more than \$4,600,000 to Canadian concerns for engineering services. It has paid over \$3,400,000 in salaries to its employees in Canada and has expended approximately \$2,700,000 in Canada for insurance, legal, accounting and other expenses. These expenditures

Standing Senate Committee

in Canada represent monies generated by C I Power's subsidiary companies in their respective countries of operation. As such, they represent direct contributions to Canada's balance of payments without the requirement of investment of additional Canadian capital.

C I Power also makes a significant contribution to the relations between Canada and the countries in which it operates by placing Canadians in important positions in these operations. They act as unofficial ambassadors of Canada in the frequent contacts they have with local citizens in the course of their business activity. The presence of Canadians in these foreign operations cannot help but be beneficial to the image of Canada. To enhance this local partnership with Canadian industry still further, it has been the policy of C I Power to encourage local residents of foreign countries to acquire shares in the local operating companies, which are known to be Canadian-controlled enterprises.

We believe that it would be unjustifiable and detrimental to the Canadian economy if these significant contributions were to be lost to the Canadian economy through adverse tax legislation, which could render it impossible to continue to operate these activities from Canada.

SPECIFIC PROPOSALS OF THE "WHITE
PAPER" WHICH AFFECT C I POWER

There are a number of specific points in the "White Paper" which affect C I Power, its subsidiaries and its shareholders. Without the benefit of the Supplemental White Papers, our comments are, of necessity, brief. We may have additional comments when those Papers are released.

In the discussions which follow, terms such as "controlled foreign corporation", "widely-held", "closely-held", are used in the same context as in the "White Paper".

1. The Tax Status of Dividends from
Controlled Foreign Corporations

C I Power operates principally through foreign subsidiaries and through Canadian subsidiaries operating solely abroad.

Under present law, dividends from controlled foreign corporations and controlled foreign business corporations (as defined in section 71*) are exempt from Canadian income tax (section 28 (1) (d) and (e)). The proposed revision would exempt dividends from controlled foreign operating corporations only if bilateral tax treaties are entered into with the source country. It would phase out the exemption under section 71 for Canadian corporations whose operations are solely abroad.

It is submitted that the taxation of foreign-source income should be established independently of political agreements. We stress that Latin American countries - the location of C I Power operations - have been openly reluctant to enter into tax agreements of any kind: for this reason the prerequisite for continued exemption would appear to be illusory. In any event, it is difficult to understand why a growing Canadian community of interest with Latin America should be burdened by a call for treaties to which these nations are known to be averse. Such being the case, it is urged that the Government at this time make

* All section references are to the Income Tax Act.

the decision which it appears that it will have to make in any event no longer than five years hence, and unilaterally continue the exemption of dividends from controlled foreign operating corporations.

In any event, in the long-term economic interest of Canada and as a part of Canada's participation in the free world's contribution to less fortunate peoples and nations, a distinction should be made between dividends which have their source in developing countries - the countries least likely to enter into treaties - and dividends from other countries, with which treaties probably can be negotiated. It is recommended that should the treaty requirement be retained, developing nations be designated as treaty countries whether or not treaties are in fact made with them.

2. The Taxation of a Foreign Branch
Differently from a Foreign Subsidiary

Bolivian Power Company Limited, a C I Power subsidiary, is a Nova Scotia corporation operating entirely in Bolivia; it is presently exempt from Canadian tax as a foreign business corporation.

The income of a controlled foreign operating corporation in a non-treaty country would be taxed only when remitted to the Canadian parent and not at all where the source is a treaty country. The income of an unincorporated foreign operation of a Canadian corporation - whether its entire operation or a branch - would be taxed by Canada when earned, whether or not remitted, and whether or not in a treaty country. See paragraph 9 below for the separate problem which results in some cases from local restrictions on remittance.

This discrimination between foreign branch and foreign subsidiary operation is completely indefensible, particularly since the Canadian operation of a foreign corporation is taxed approximately the same whether conducted as a branch or a subsidiary. The branch and the subsidiary function identically and except for the accident of place of incorporation are indistinguishable. To recognize this domestically and deny it in the foreign area is discriminatory.

The foreign business corporation (as defined in section 71) encouraged the use of Canadian corporations to operate businesses abroad; thus businesses which otherwise would have been incorporated in the country of operation were incorporated in Canada. The "White Paper" contemplates that present foreign branch and foreign business corporation operations will be converted into foreign subsidiaries. This, however, may be either impractical or virtually impossible: often the conversion will be treated in the foreign country concerned not as a mere change in the place of incorporation but as a complete windup of the existing entity and the formation of a new entity, requiring payment of statutory severance pay to employees, substantial property transfer taxes, and renegotiation of franchises and licences; existing benefits enjoyed under grandfather clauses may be lost forever. The cost would be irreparable. This is the situation of Bolivian Power Company Limited. It would be only equitable that for income tax purposes the foreign operation be classified and taxed as a foreign subsidiary, whether in fact incorporated in the country in which it operates or not.

3. The Exclusion from the Foreign Tax
Credit of "Spared" Taxes

Bolivian Power Company Limited has been exempted

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from Bolivian federal income taxes so that its rates to customers can be maintained at a lower level than that at which they otherwise might be set.

In computing the foreign tax credit, it is the general rule that credit will be allowed only for taxes paid or deemed paid. However, because of a practice in developing countries called "tax sparing", whereby in setting rates which may be charged by public utilities, the utility is exempt from or spared income taxes so that the rates charged consumers will be less by the amount of the spared tax, credit should also be allowed for the spared tax. The purpose of the tax sparing is defeated unless other jurisdictions which tax the income of the utility recognize and take into account for tax credit purposes the amount of tax spared. Had there been no tax sparing by the host country, the Canadian tax would be substantially offset by the credit for the tax that would have been paid the host country. If credit is not allowed, rates will have to be increased and the sparing waived but neither Canada nor the taxpayer will benefit: the low income customer will be out of pocket and less able to use electricity. It is urged that tax sparing be incorporated in the foreign tax credit provision where the income source is a bona fide operation in a developing country, whether for equitable reasons or as a Canadian contribution to more rapid development.

4. The Taxability of Dividends Received by Widely-held Canadian Corporation from a Closely-held Canadian Corporation, the Source of Whose Income is Dividends from Controlled Foreign Corporations

C I Power has two closely-held Canadian holding company subsidiaries (Monterey Railway, Light and Power Company and International Power Company Limited) which

themselves have foreign operating subsidiaries; the latter are controlled foreign corporations.

A closely-held Canadian corporation will not be taxed on a dividend from a controlled foreign operating corporation located in a treaty country. However, such dividend will be taxed when passed up to the widely-held Canadian parent of the closely-held Canadian corporation (because it will not have borne tax in the hands of the closely-held corporation so the grossing up and credit procedure is of no avail).

The taxation of the dividend as it passes from the subsidiary to the parent completely destroys the purpose of allowing the subsidiary to receive the dividend from the controlled foreign operating corporation free of Canadian tax. In order that the intent of the law be preserved, it is urged that with respect to dividends from controlled foreign operating corporations, Canadian subsidiaries of Canadian corporations be treated as conduits so that the foreign source dividend can be received by the parent tax free.

5. The Measure of Gain on the Sale of
Stock of Controlled Foreign Corporations

C I Power operating subsidiaries grow and expand in great part through the use of retained earnings; thus much of the increase in their value results from the retention of earnings.

Gain on sale of shares of a controlled foreign operating corporation would be taxed to the Canadian parent. The measure of such gains would be the excess of the amount realized on the sale over the cost or other basis to the

parent. Since a substantial element in the appreciation in value of stock is the amount of retained earnings of the corporation, capital gains taxation of the portion of the gain represented by retained earnings is illogical and inequitable because, in the case of treaty country corporations, such retained earnings could have been passed up to the parent tax-free in Canada by way of dividend. Similarly, in the case of non-treaty country corporations, the retained earnings could have been passed up to the parent at a Canadian tax price reduced by credit for the foreign taxes paid by both the shareholder and the corporation. It is obvious that a substantial element of the taxable gain can be avoided by distributing earnings to the parent immediately prior to the sale. It is suggested, therefore, that the seller be spared resort to such manoeuvres by reducing the measure of capital gain on sale of stock of a controlled foreign operating corporation by the amount of earnings accumulated during the holding period of the shares sold and by increasing the seller's tax on the gain thus adjusted by the amount of tax, if any, which he would have paid had such retained earnings been distributed to him.

Moreover, in cases (such as Venezuela) where C I Power is taxed locally on gains on the sale of shares, provision should be made for the credit against Canadian tax (if any) on the gain, in respect of the local tax (in this case Venezuelan) paid on the same gain.

6. The Taxation of the Entire Capital Gain
on the Sale of Stock of a Closely-held
Canadian Corporation or a Foreign Controlled
Corporation which is a Subsidiary of a Widely-
held Canadian Corporation

From time to time C I Power sells off shares of

its operating subsidiaries in order to broaden local ownership in the country of operation; these subsidiaries are necessarily either closely-held Canadian corporations or foreign corporations.

There is a substantial element of inequity in treating a closely-held Canadian corporation or a foreign corporation, either of which is the subsidiary of a widely-held Canadian corporation, as other than a widely-held Canadian corporation, because basically and beneficially its ownership is widely-held. The rationale that closely-held corporations compete with proprietorships and partnerships simply is not valid where the closely-held corporation is a subsidiary of a widely-held corporation. Thus, the sale of shares of either should not be fully taxed because beneficially it is the shareholder of the widely-held corporation who is making the sale.

Similarly it makes little sense to tax in full the gain on shares of a closely-held Canadian corporation by a foreign minority shareholder when the shareholder has no close relationship with the widely-held Canadian parent corporation.

Failure to modify this proposal will inhibit efforts to broaden local ownership of foreign operating subsidiaries, one of the better means of promoting partnership between local and foreign investors.

7. The Computation of the Foreign Tax Credit on a Per-Country Basis

C I Power is constantly seeking new geographical areas of operation. Thus, although at present it operates only in developing countries which it is hoped will be designated as treaty countries whether treaties are in fact

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made with them or not (see paragraph 1 above), it is probable that it will at some time operate in a non-treaty country and thus avail itself of the foreign tax credit.

The net Canadian tax on taxable foreign-source income is largely a function of the credit allowed for foreign taxes paid or deemed paid, and will assume a greater importance under the proposal when dividends from non-treaty countries become taxable. Under existing law the foreign tax credit is computed on a per-country basis. However, because the reasoning basic to the new law is to allow full credit for foreign taxes paid or deemed paid, it appears that allowance of the foreign tax credit on a global basis (as does the United States tax law) would be a more equitable solution and more reflective of the true economic position of the Canadian taxpayer having foreign-source income.

8. The Limitation of the Foreign Tax
Credit to Foreign Taxes of the
Canadian Holder and the First-Tier
Controlled Foreign Corporation

For both local and historical reasons, C I Power's ownership of foreign subsidiaries is organized in more than one tier in some instances (see Appendix "A").

The computation of the foreign tax credit in respect of taxable dividends from controlled foreign operating corporations contemplates taking into account only foreign taxes paid by the Canadian parent and by the first-tier controlled foreign corporation. There would appear to be no reason so to limit the creditable taxes; where a controlled foreign corporation's status exists beneficially through direct or indirect ownership, the foreign taxes paid

by that corporation should be allowed as a credit against the Canadian tax of the qualifying shareholder without regard to whether the foreign corporation is first-tier or fifth-tier. Inasmuch as tiers exist for local business or political reasons, arbitrary denial of credit because a corporation is not an immediate subsidiary of the Canadian parent would be highly discriminatory.

9. The Inclusion in Taxable Income of
 "Blocked" or "Frozen" Income

Bolivia has ordered that dividend payments to foreign shareholders be deposited in a non-interest-bearing account in a local bank for a minimum period of one year. Bolivian Power Company Limited, a C I Power subsidiary, is treated by Bolivia as a Bolivian corporation although it is incorporated in Nova Scotia. As an example, there is a Bolivian withholding tax on Bolivian Power dividends.

The income of a foreign operation (when not treated as a subsidiary) would be taxed without regard to whether or not the net income can be remitted to the home office in Canada. Often remittance is not possible because of exchange or other legal restrictions imposed by the host country. This means essentially that the home office would be liable for a tax on income not available to it and for which it may have no funds to pay because in fact there has been no Canadian realization or collection of income. The equitable solution is either to defer collection of tax on blocked or frozen income, or to defer recognition of such blocked or frozen income.

Section 54(7) of the Income Tax Act does not solve this problem satisfactorily in that it only provides for deferral of tax in certain rigidly-defined circumstances,

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and it is unrealistic to suppose that the Bolivian Government (for example) would ever remove the exchange control restrictions for the sole benefit of the Canadian Government. In other words, mere postponement of taxes under rigidly-defined circumstances is not enough.

10. The Taxation of Capital Gain Arising
 from Forced Realization of Foreign
 Assets

Corporations operating in developing countries must constantly be prepared for the possibility of expropriation, and this is especially true in the field of public utilities. In 1962 Monterey Railway, Light and Power Company, a C I Power subsidiary incorporated under the Companies Act of Canada and operating only in Mexico, was forced to sell its operating properities to an agency of the Mexican Government. Except for the initial payment the purchase price was in serial notes maturing over a 15-year period; the proceeds of the notes must be reinvested in Mexico.

It has been proposed to defer taxation of capital gain arising from forced realization if replacement in similar property is made within one year of receipt of the proceeds, although it should be observed that even the one year is not specifically allowed in the International Section. This rule is reasonable where the realization is by way of insurance compensation for casualty or theft. However, where the expropriation is of an entire business and in a foreign country the requirements that replacement be "in similar property" and "within one year of receipt of the proceeds" often cannot be complied with, especially if terms of the forced sale require reinvestment in the

same country. Expropriation of a business generally is part of nationalization of an entire industry: therefore either reinvestment cannot be made in the same country in the same type of business, or majority ownership is prohibited. For the same reason, one year is too short a time in which to effect replacement. It is suggested that where an operation is expropriated or made the subject of a forced sale of either properties or stock, the replacement requirement be satisfied by the acquisition of at least 25% voting interest in one or more operating companies or additional investment in such a company, without regard to the nature of the operation, and that a five-year period from receipt of the money be allowed in which to make replacement.

11. The Taxation during the Replacement
 Period of Passive Income from Funds
 Derived from Forced Realization

Monterey Railway, Light and Power Company has found suitable reinvestment in controlled (25%) situations to be a slow and difficult process, and as a consequence some funds have had to be invested temporarily in securities which produce passive income.

Income from funds received upon a forced sale and held for the purchase of replacement property, as well as interest on non-transferable obligations given against receipt of future payment, are generally passive income. The reasoning underlying treatment of forced realizations however requires in the interests of equity that such passive income be treated for tax purposes as though it were income from the property converted, thus preserving the owner's status and leaving him completely unaffected taxwise by the forced realization.

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12. The Phase-Out of Tax Exemption of
Foreign Business Corporations

Bolivian Power Company Limited, a C I Power subsidiary, is a Nova Scotia corporation operating entirely in Bolivia. It is presently exempt from tax as a foreign business corporation.

The phase-out over a five-year period of the tax exemption of a foreign business corporation (as defined in s.71) engaged in active operations has little to justify it. The "White Paper" contemplates that foreign business corporations will become foreign corporations: if this can be effected immediately there is no need for the phase-out; if the full five-year period is required to make the change, a moratorium during which the full exemption remains in effect is desirable. Canada will not be the loser because if conversion is effected immediately, any dividends from the new foreign corporation will be exempt for at least a major portion of the five-year period.

13. The Taxation of Unrealized Appreciation
in Shares of Widely-held Canadian
Corporations by Revaluation Every Five
Years

C I Power is a widely-held Canadian corporation. More than 25% of its voting shares are owned by The United Corporation, a publicly-held United States investment company. The considerations set out in this paragraph apply not only to The United Corporation but to all the Canadian shareholders of C I Power as well.

In the economic sense and in a practical business sense, unrealized appreciation in value should not be used as

a base for any kind of taxation. It is in essence a purely hypothetical figure subject always to changes in the general economic climate and in the condition of the particular enterprise.

To segregate from the whole value of the enterprise a segment of hypothetical gain upon which to impose a confiscatory tax violates every principle of fair tax treatment. It is based upon the fallacy that unrealized gain in some unreal way is part of income. But income by its very nature is a realization of actual profit reflected in dollars. It is the final outcome of the tangible activities of the enterprise as it affects the specific shareholder.

The nearest analogy to what is being attempted is an ad valorem property tax. Such a tax, levied in small fractions, is imposed upon the total value of property ascertained according to rigid formulae for any given time - and applied uniformly to all property of like kind and all owners thereof. The proposed tax fails in many ways to meet the fair standards of an ad valorem property tax.

So-called unrealized appreciation in corporate property is due in no small measure to the plowing back of earnings already taxed at the corporate level into the capital structure of the enterprise. If a heavy tax must be faced every five years on the results of plow-back of earnings, that efficiently economical method of accumulating needed new capital in the enterprise will be discouraged.

This proposal will discourage investment in stocks of widely-held Canadian corporations because few investors will wish to assume the necessity of an out-of-

pocket payment or an involuntary sale of securities to obtain money to pay the tax.

The effect is especially harmful where the shareholder of the enterprise is not a resident of Canada. Since in any given case the non-resident may not have other Canadian investments (or even any Canadian-source income), he will be deprived of the opportunity available to Canadian residents of offsetting the theoretical five-year gain against a possible five-year loss in other securities. In the converse case, if the non-resident shows a theoretical five-year loss on securities, he is less likely to have any Canadian income against which he can offset the loss; nor can he of course claim the loss in his country of residence since it is not realized.

Double taxation is abhorrent to all who believe that a system of taxation must be fair, just and non-discriminatory. Yet the proposal to tax unrealized appreciation of corporate shares clearly will involve double taxation where the theoretical appreciation is based in whole or in part on undistributed earnings. When those earnings are distributed, they will again be taxed to the shareholder.

14. Taxation of Non-resident Shareholders
 on Realized Gains on Sales of Shares
 of C I Power

Apart altogether from the taxation of unrealized capital gains, we submit that non-residents of Canada should not be subjected to tax on capital gains at all, i.e. even on realized gains. So far as we are aware, an attempt to impose such a tax would place Canada in a precedent creating category, but a highly undesirable one and certain to act as a deterrent to foreign investment in Canada. When we say this, we bear in mind that neither

the United States nor the United Kingdom taxes non-residents on gains on the disposal of shares of domestic companies unless the disposal is associated with a business venture in that country.

Moreover, it is submitted that it would be impossible to police such an attempt at taxation effectively: sales between non-residents are not necessarily recorded within Canada at all, so that in such cases the proposed "certificate of compliance" procedure would be rendered nugatory. The ineffectiveness of this proposal would not only extend to cases in which the shares of the Canadian companies concerned were held by foreign nominees and continued to be held by the same nominees notwithstanding the sale, but would also extend to the obvious case where the non-resident vests the Canadian shares in a foreign holding company and sells the shares of the holding company to another non-resident.

We accordingly urge that the proposal to tax non-residents on gains resulting from the sale of shares of Canadian companies be abandoned.

15. The Taxation of Unrealized Appreciation
of Property when a Taxpayer Gives up
Canadian Residence

C I Power and similarly situated enterprises employ numerous management and technical personnel who are rotated between the home office in Canada and foreign posts, alternating assignments every two or three years. The requirement that a taxpayer be deemed to have sold all his property when he gives up Canadian residence will make it difficult and more costly to get staff members

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to accept foreign assignment, to the detriment of the Canadian presence abroad. For this purpose, distinction should be made between an intended permanent change of residence and an absence for a relatively ascertainable period.

16. The Taxation of Foreign Passive Income
 Derived from Retained Earnings held for
 Investment in Capital Equipment

C I Power operating subsidiaries grow and expand in great part through the use of retained earnings. These accumulations are often invested temporarily in passive income-producing securities while awaiting appropriation to plant and equipment purchases.

Where a controlled foreign corporation operates in a treaty country, dividends to its parent will be tax-free except to the extent that they are paid out of passive income. However, in most cases the passive income derives from retained earnings awaiting investment in operating equipment. For a reasonable period and in respect of a reasonable amount of accumulation, or where the amount of passive income is deemed minimal (the United States tax law ignores passive income of controlled foreign corporations where it is less than 30% of gross income), such income should not be taxed as passive income because the accumulations are not "merely devices of convenience to which income from other sources may easily be diverted". ("White Paper" paragraph 6.20).

17. Inequity in Foreign Investment

The tax credit on dividends should be the same for all Canadian corporations whether they derive

their income from foreign sources or Canadian sources. Should the proposal on tax credit to resident shareholders be implemented, we strongly urge an exception for dividends from income from developing nations because of their great need for capital. Obviously, if a like tax credit is not available to foreign source income, such discrimination would tend to induce investors to buy Canadian equities in preference. Both the Government and the private sector have a responsibility for bringing needed capital to developing nations. The Government should encourage the private sector to play its part.

18. The Shareholder's Credit for Taxes
Paid by the Corporation

C I Power income will not be fully taxable in Canada, either because its source is a treaty country or because if taxable, Canadian tax will be reduced by a substantial foreign tax credit. Thus, C I Power Canadian shareholders will not be eligible for the full 50% creditable tax against their grossed-up dividends.

Individual shareholders of widely-held corporations and corporate shareholders of all corporations are granted dividend-received credits reflecting the Canadian tax paid by the payor corporation. A Canadian corporate shareholder of a controlled foreign operating corporation in a treaty country is exempt from tax on dividends from operating income. Just as a corporation which has both domestic and foreign source income is deemed to pay the foreign source income out first for purposes of foreign withholding tax flow-through, so should the income on which Canadian tax is fully paid be deemed the first distributed for purposes of the

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dividend creditable tax. Similarly, operating income should be deemed to be the first distributed for purposes of the receipt of dividends from controlled foreign corporations.

Further, because a foreign shareholder would receive no benefit for Canadian taxes paid by the corporation, the total of such Canadian taxes should be credited to Canadian shareholders, thus encouraging Canadian investment in Canadian corporations.

CONCLUSIONS

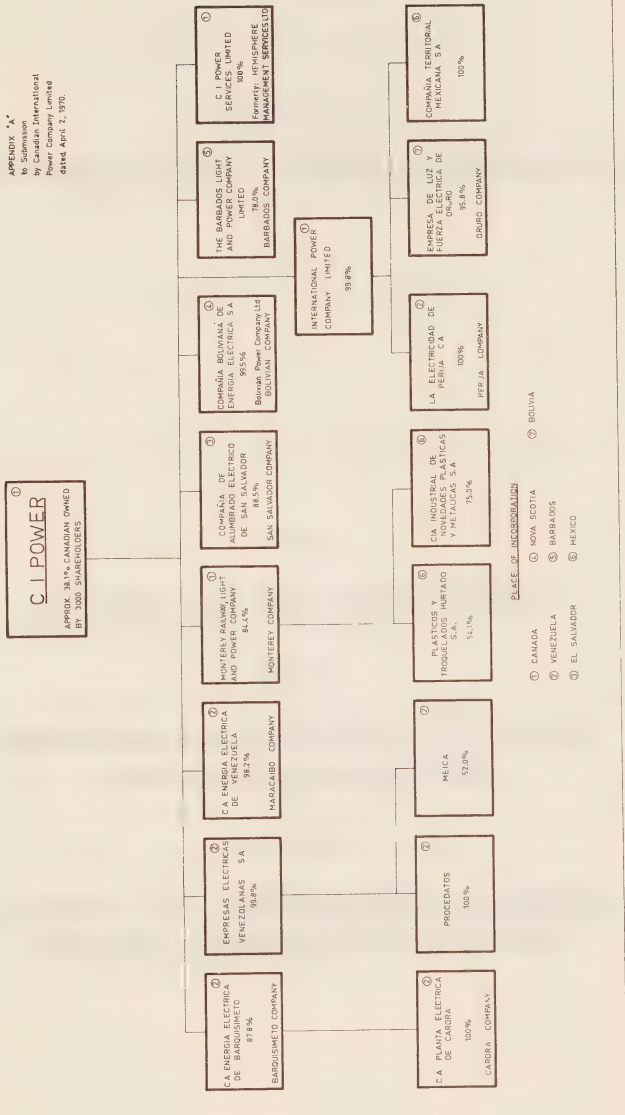
In conclusion, we suggest the "White Paper" Proposals with which we have concern can be equitably solved as follows (paragraph numbers coincide with those in the foregoing detailed submissions):

1. With respect to dividends from controlled foreign operating corporations, either sections 28 (I)(d) and (e) be continued, or, if the treaty requirement is retained, developing countries be designated as treaty countries whether or not treaties are actually made with them.
2. With respect to taxation of foreign operations of a Canadian corporation, the branch operation should be taxed as if it were a separate foreign subsidiary; alternatively, section 71 should be continued for Canadian corporations directly engaged solely in foreign operations.
3. With respect to computation of the foreign tax credit, foreign taxes spared by the source country should be deemed to have been paid.
4. With respect to dividends received by a widely-held Canadian corporation from a closely-held Canadian corporation having

4. income from controlled foreign corporations, the closely-held Canadian corporation should be treated as a mere conduit.
5. With respect to capital gain on sale of stock of controlled foreign corporations, the portion of such gain attributable to retained earnings should be taxed, if at all, as if such earnings had been distributed to the seller at the time of sale.
6. With respect to capital gain on sale of shares of foreign or domestic subsidiaries of widely-held Canadian corporations, such subsidiaries should be treated as widely-held Canadian corporations.
7. With respect to computation of foreign tax credit, any limitation should be on a "global" rather than a "per country" basis.
8. With respect to computation of foreign tax credit, credit should not be restricted to taxes paid by the first-tier foreign subsidiary.
9. With respect to "blocked" or "frozen" income, either such income should not be taken into account until unblocked, or collection of tax thereon should be deferred under less stringent conditions than those of the present section 54(7).
10. With respect to non-recongnition of gain from forced realizations, a five-year replacement period and a liberal definition of "similar property" are necessary to accomplish the desired result.
11. With respect to passive income arising from the proceeds of forced realizations awaiting investment in replacement property, such passive income should be treated as being of the same nature as income from the property converted.
12. With respect to foreign business corporations, a full five-year extension of the current exemption should be granted those directly engaged in active operations.
13. The Proposal to tax unrealized appreciation in value of shares of widely-held Canadian corporations should be deleted.

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14. Non-residents should not be subject to Canadian capital gains tax at all, i.e. not even on realized gains from the sale of shares of Canadian corporations.
15. With respect to taxation of unrealized appreciation in value of property of persons removing from Canada, distinction should be made between an intended permanent change of residence and an absence for a relatively ascertainable period.
16. With respect to foreign passive income derived from retained earnings held for investment in capital equipment, such income should not be taxed as passive income.
17. With respect to resident shareholders' tax credit, the credit should be the same for all shareholders, whether the income is derived from Canadian sources or foreign sources.
18. With respect to dividend credit to shareholders, the first income deemed distributed should in every case be that which results in maximum credit to shareholders.



APPENDIX "B"

Submission of

THE CANADIAN MUTUAL FUNDS ASSOCIATION

on the

WHITE PAPER ON TAX REFORM

to the

SENATE COMMITTEE ON BANKING,
TRADE and COMMERCE

and the

COMMONS COMMITTEE ON FINANCE,
TRADE and ECONOMIC AFFAIRS

A SUBMISSION TO

THE HOUSE OF COMMONS COMMITTEE
ON FINANCE, TRADE AND ECONOMIC AFFAIRS

AND

THE SENATE COMMITTEE ON BANKING
TRADE AND COMMERCE

STUDYING THE WHITE PAPER ON TAX REFORM

PRESENTED BY

THE CANADIAN MUTUAL FUNDS ASSOCIATION

PART I

(DEALING WITH THOSE PROPOSALS CONTAINED IN THE WHITE
PAPER WHICH RELATE EXCLUSIVELY TO MUTUAL FUNDS)

THE CANADIAN MUTUAL FUNDS ASSOCIATION

1. The Canadian Mutual Funds Association ("C.M.F.A.") represents forty-four leading mutual funds. The combined asset value of these member funds as at December 31, 1969 stood at \$2,677,602,252.00, or approximately 90% of the value of the assets of all Canadian mutual funds combined. Member funds alone maintained at the close of 1969 not less than 744,873 individual shareholder accounts.

DEFINITION OF MUTUAL FUND

2. The Canadian Committee on Mutual Funds and Investment Contracts ("the Canadian Committee") established by the Federal and Provincial Governments in August, 1966 has defined the term "Mutual Fund" in the following manner:

"the term "mutual fund" should be defined to include any organization which issues, offers for issuance, or has outstanding instruments (whether called shares, units, or by another term) that entitle the holder to receive, on demand or within a specified period after demand, an amount computed by reference to the value of a proportionate interest in the assets of the issuing organization." *

3. It is worth noting that such definition does not extend to closed-end investment companies which are incorrectly referred to in the White Paper as closed-end mutual funds. A closed-end investment company does not have outstanding redeemable shares which entitle the holder thereof to receive on demand an amount as specified in the Canadian Committee definition.

* Report of the Canadian Committee on Mutual Funds and Investment Contracts (1969) P.117

4. The Canadian Committee also stated that:

"the essential characteristic of all mutual funds is that they are vehicles to facilitate the pooling of moneys which belong to a number of investors for investment as a single portfolio, with losses and gains experienced by the portfolio being passed through to the participants." *

RECOMMENDATIONS OF WHITE PAPER
RELATING TO MUTUAL FUNDS

5. Those recommendations contained in the White Paper which relate specifically to mutual funds appear at Sections 4.61 and 4.62. They may be briefly summarized as follows:

- a) mutual funds would be treated as widely-held corporations;
- b) shareholders of mutual funds who receive capital gains on the sale of shares of public Canadian corporations (presumably widely-held corporations) or dividends from such corporations flowing-through the mutual fund would be subject to the same tax as if they

* Ibid P.1

had received such dividends or gains directly, (see Appendices I and II);

- c) the conduit or flow-through treatment referred to in (b) would not be available in respect of dividends from shares of closely-held corporations, nor in respect of gains other than on the sales of shares of public Canadian corporations which are routed through a mutual fund.

OBJECTIONS OF THE CMFA TO
PROPOSALS SET FORTH IN
SECTIONS 4.61 and 4.62

6. It is stated in Section 1 of the White Paper that the first and perhaps most important aim of tax reform is to "include a fair distribution of the tax burden". (See Section 1.6). "Fairness in taxation implies two principles. First it means that people in similar circumstances should carry similar shares of the tax load." (See Section 1.8).

7. The denial of conduit or flow-through treatment for mutual funds in respect of all but dividends from shares of widely-held corporations and gains on the sale of such shares is inequitable. It will have the result of placing a much heavier burden of the "tax load" on the person who invests through a mutual fund than on the direct investor. Mutual fund shareholders will carry a 12½% to 25% greater share of the "tax load" than will direct investors, as appears from the comparisons set forth in Appendices III, IV, V and VI. The extra burden will fall most significantly upon Canadian taxpayers in the low income groups.

8. The mutual fund shareholder would also bear a greater share of the tax load than the direct investor with respect to the five-year revaluation proposal. If this proposal is accepted the mutual fund shareholder would be required to revalue his shares in the mutual fund every five years. Such revaluation would almost invariably be affected by the value of unrealized gains in other than widely-held securities. Direct investors would not be required to revalue their holdings in other than shares of widely-held corporations.

9. It is stated in Section 6.6 of the White Paper that foreign capital is essential to the development of Canada. Concern has, however, frequently been expressed that such foreign capital carries with it control of our industry. The investment of foreign capital through the medium of a Canadian mutual fund is the most desirable way of securing foreign equity capital without endangering Canadian control. Since a Canadian mutual fund may never control a specific corporation, foreign investment channelled through a mutual fund does not deprive Canadians of any element of control. If the recommendations of the White Paper are adopted a foreign shareholder of a Canadian mutual fund would suffer tax at the following rates as compared to no tax, or at the most, a withholding tax payable by a foreign direct-investor, i.e.

- a) 43-1/3% on capital gains on shares of widely-held Canadian corporations,
- b) 57½% on interest and other capital gains,
- c) 50% on foreign dividends.

The taxation of foreign shareholders at these excessive rates will destroy the investment incentive to this foreign capital and one of the most desirable forms of foreign investment will be lost to Canada.*

10. Mutual funds have for many years been considered attractive investment media for retirement savings plans as well as pension funds. These plans and funds presently enjoy tax free status in respect of income earned by them. The White Paper proposes that this status be maintained for these plans or funds subject to the conditions that:

- a) they "should not be entitled to the credit for corporation income tax proposed for dividends on shares in Canadian corporations", (see Section 2.47), and
- b) to qualify for tax-free status they "must invest no more than 10% of their assets in foreign securities or other foreign investments", (see Section 2.52).

* This type of investment has developed comparatively recently and as of December 31, 1969 foreign shareholders (mostly European) had already invested in excess of \$51,000,000.00 - through Canadian mutual funds which are members of the C.M.F.A.

11. The justification offered for condition (a) is that "Freedom from tax on dividends and interest and capital gains should be sufficient", (See Section 2.47). If it is suggested that condition (a) is intended to bring about reasonable equity, whatever equity is thereby achieved is lost for those plans and funds investing their resources through a mutual fund if the White Paper approach to the taxation of mutual funds is accepted.

12. A pension fund or retirement savings plan which routes its investments through a mutual fund will be taxed on dividends, interest and capital gains whereas a fund or plan which invests directly will not. This is apparent from a study of the example set forth in Appendix VII. In the case of Canadian source interest and capital gains on other than shares of widely-held corporations the fund or plan which invests directly will receive a return which is 100% greater than the return to the fund or plan making the same investments through a mutual fund.

13. To place this obvious inequity in its proper perspective it is estimated that as of December 31, 1969

pension funds and registered retirement savings plans had invested in excess of \$190,000,000.00 through mutual funds in Canada. It is reasonable to assume that these funds and plans will not tolerate the enormous tax difference between direct investment and mutual fund investment. Unless the proposal to tax mutual funds is abandoned these plans and funds will be required to liquidate their present investments in mutual funds and either invest in the market directly or in the case of pension funds, transfer these investments to special tax-free trusts. If this course is followed it could have a substantial effect on the market. The economies and other advantages of pooled investment through mutual funds would be lost to these plans and funds. This would be particularly serious for the holders of registered retirement savings plans.

14. Condition (b) referred to in paragraph 10 could also create serious problems. If, as of a given date, all pension funds and retirement savings plans were required to invest 90% of the moneys presently held by them in Canadian assets the sudden shift of investment could bring considerable havoc to the capital

market. It is strongly suggested that a transition period be provided if the 90% Canadian asset test is to be adopted. The C.M.F.A. suggests such period should be three years from the effective date of the appropriate legislation.

15. There is no justification for the serious difference in the "tax load" carried by a mutual fund shareholder when compared to a direct investor in certain circumstances. The White Paper, however, offers the following explanation at Section 4.61: "The relationship of the shareholder of the mutual fund to his corporation is much the same as that of shareholders of other public corporations to their corporations." Hence the income of the mutual fund should be taxed in the manner outlined.

16. This explanation is quite inaccurate. The relationship of the mutual fund shareholder to the mutual fund is not much the same as that of other shareholders to their corporations for the following reasons:

- a) the essence of the relationship between a mutual fund and its shareholders is that the mutual

fund must at the request of its shareholder redeem for cash the shares held by such shareholder.

"Other corporations" are generally prohibited from doing this; and

- b) "other public corporations" generally carry on some business activity, and, as mentioned in Section 4.34 it is likely that some level of corporation tax is passed on to customers in the price which the corporations charge for their goods and services. A mutual fund has no customers and therefore cannot pass on any part of its taxes to them. It is little more than an agent for its shareholders. It is a vehicle to facilitate the pooling of moneys, as was said by the Canadian Committee.

ALTERNATIVE PROPOSAL
SUGGESTED BY C.M.F.A.

17. In order to avoid the serious inequities which will result if the present proposal for the taxation

of mutual funds is accepted, the C.M.F.A. recommends that for income tax purposes mutual funds be given conduit or flow-through treatment similar to that available to mutual funds in the United States. Such treatment could be given by permitting mutual funds to elect to be treated as partnerships in somewhat the same manner as is recommended for closely-held corporations under Section 4.21. Neither the unanimous consent of all shareholders nor the absence of foreign shareholders should be required for such treatment in the case of mutual funds.

18. In order to be entitled to elect such conduit treatment it is recommended that a mutual fund be required:

- a) to distribute (within say two or three months after the end of its fiscal year) at least 90% of its available earnings including net realized capital gains and 100% of any carryover of earnings or gains not distributed in a previous year, and
- b) to report to each shareholder annually such information relative to the earnings

and distributions of the mutual fund as may be prescribed by regulation.

In order to achieve greater equity between new and redeeming shareholders and the continuing shareholders of a mutual fund all mutual funds would undoubtedly make such distributions at least on a half-yearly basis and probably quarterly.

19. The application of conduit treatment for mutual funds is not without precedent. In the United States mutual funds are treated as conduits. As regulated investment companies they are permitted to deduct from their income dividends paid to their shareholders in the year. They are taxed only on income and realized capital gains retained by them and this has generally been considered a practicable and equitable way of taxing mutual funds and their shareholders.

20. Under the provisions of Sections 79D and 68A of the Canadian Income Tax Act, life insurance companies are permitted conduit treatment for income earned upon the investment of their segregated funds.

21. The application of conduit treatment to the income of mutual funds presents no administrative problems with respect to shareholders who do not redeem during the year. At the end of each year the mutual fund would distribute to each shareholder his proportionate share of at least 90% of what would otherwise be the income of the mutual fund. Upon such distribution the shareholder would receive a statement identifying the amount paid to him in relation to its original source. The shareholder would add the amount of such distribution to his income in the appropriate categories of interest, dividends or gains on shares of closely-held or widely-held corporations as the case may be. He would be entitled to the appropriate tax credits on the amounts so categorized and would thus pay the same amount of tax on the amount distributed as if he held the shares directly rather than through a mutual fund.

22. It has already been stated that a mutual fund shareholder is entitled at any time to redeem his shares for their net asset value. It is this feature which creates certain technical or administrative problems relative to the taxation of mutual fund

shareholders. This would be true not only under the recommendation in this brief that mutual funds be permitted conduit treatment but equally true under the widely-held treatment recommended for mutual funds in the White Paper.

23. At any given time a mutual fund may have on hand as part of its assets unrealized gains of one sort or another as well as realized but undistributed gains. A shareholder who redeems is paid an amount which is in part referable to his shares of these two items. If such redemption constitutes a gain to the shareholder over the cost to him of the shares redeemed one-half of such gain would be included in his income if the mutual fund is treated as a widely-held corporation. If a significant part of the gain were attributable to unrealized gains on foreign investments the redeeming shareholder would have a tax advantage under the proposals set forth in the White Paper. Foreign gains realized in this manner, would, in effect, be taxed as if they were gains on shares of widely-held corporations. If the foreign securities were ultimately realized the higher income taxes payable on such realization under the White Paper proposals would be paid by the

mutual fund and the value of the interest of continuing shareholders would be reduced accordingly.

24. If all of the unrealized gains were in respect of shares of widely-held corporations this advantage to the redeeming shareholder would not exist but upon realization an additional tax load would be carried by the continuing shareholders and there would, to a certain extent, be double taxation.

25. At present a person who buys shares of a mutual fund with undistributed income on hand is buying into a tax liability, although this is minimized by the present practice of mutual funds paying out practically all of their income each year by way of dividends. Likewise, either under conduit treatment or the White Paper proposals, anyone buying shares of a mutual fund with unrealized gains on hand is buying into a potential tax liability.

26. It would, under most circumstances, appear to be impossible to provide absolute equity to a redeeming mutual fund shareholder particularly when a mutual fund portfolio consists of widely-held as well as

other securities. It is suggested, however, that if conduit treatment is permitted for mutual funds reasonable equity could be achieved if the following further suggestions are adopted.

27. A person who redeems or sells his shares of a mutual fund would bring into his income for tax purposes the whole or part of his gain or loss on the redemption of such shares according to the following rules:

- a) if the mutual fund elects, in a prescribed form, that its unrealized gains on investments other than in shares of widely-held corporations will not at the end of its fiscal year exceed a prescribed amount (say 10% of its asset value) then such shareholder would include in his income only one-half of such gain or loss in the same manner as if the redemption of his shares were a sale of shares of a widely-held corporation;

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- b) if the mutual fund does not make the election referred to in (a) or (c) then such shareholder would include in his income the whole of such gain or loss in the same manner as if the redemption of his shares were a sale of shares of a closely-held corporation;
- c) if the mutual fund so elects and the shareholder redeemed or sold at a gain or loss then a portion of the gain or loss, as the case may be, would be deemed to be referable to a gain or loss on a foreign or closely-held security in the same proportion as, the quarterly average of the portfolio of the fund invested in foreign and closely-held equities over the two years ending with the end of the immediately preceding taxation year, bears to the total quarterly average value of the portfolio of the fund during that time and the balance of

the gain or loss would be treated
as a gain or loss on a Canadian
widely-held corporation.

28. Many mutual fund shareholders have systematic withdrawal plans involving regular monthly redemptions. They would, under the foregoing proposals, be able to use the same proportion for each monthly payment during the calendar year, thus keeping the preparation of their tax returns comparatively simple.

29. If a mutual fund makes the election permitted under paragraph 27(a) it would not thereafter be entitled to elect other treatment without the prior approval of the Minister of National Revenue. If such an election is made and at the end of the mutual fund's fiscal year the amount of unrealized gains on investments other than in shares of widely-held corporations exceeds the 10% limit it would be required to either:

- a) within a prescribed period of time pay out to its shareholders as a special dividend the amount by which the value of unrealized gains exceeded the 10% limit, or

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- b) if such excess is not paid out within the prescribed period of time then the mutual fund itself would be taxed at ordinary corporate rates on the amount of such excess. This amount would be deemed to have been realized by it immediately prior to the expiry of such fiscal period but would not have to be distributed and would be deducted in future from realized gains in calculating the amount of such gains to be distributed.

VALUE OF MUTUAL FUND
SHARES ON VALUATION DAY
REFERRED TO IN THE WHITE PAPER

30. Section 3.15 of the White Paper indicates that a taxpayer would be permitted to deduct from the proceeds of sale of assets the value of those assets on "valuation day". Valuation Day will be a day close to the beginning of the new system. No clear

statement is given, however, as to what constitutes value. If value is to be equated to the quoted price of a security on an exchange or in recognized financial journals, a serious hardship could be suffered by thousands of mutual fund shareholders.

31. The value of mutual fund shares is generally reported daily in newspapers and other financial journals. The bid price so reported reflects only the net asset value per share of such mutual fund and takes no account of the sales charge which a shareholder may have paid to acquire such share.

32. In many instances the shares of a mutual fund are acquired on the basis of what are referred to as contractual plans. Under such plans a person indicates his intention to make fixed regular payments at specified intervals, usually monthly, over a specified period of time. Part of these payments are used to purchase shares of a mutual fund and the balance, often as much as 50% during the first year, is paid as a sales charge which is commonly referred to as a front-end load.* As of June 30, 1967 there were 207,898 such plans outstanding. Of this number 47%

* Report of the Canadian Committee P.43 to 45

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called for small instalments of between \$10.00 and \$24.99 each.* Such plans are sold principally to small investors. These investors will suffer a serious inequity unless, in the calculation of value on valuation date, some allowance is provided for the sales charges previously paid to acquire the mutual fund shares held on valuation day.

RECOMMENDATION AS TO THE
VALUATION OF MUTUAL FUND
SHARES ON "VALUATION DAY"

33. The Association therefore suggests that the following method be adopted in valuing the shares of a mutual fund held on valuation day:

- a) if the quoted price of shares of the mutual fund on valuation day is equal to or greater than the actual cost (including sales charges) of such shares to the shareholder, then the value should be such quoted price,

* Ibid P.46

b) if the quoted price of the mutual fund shares on valuation day is less than the actual cost (including sales charges) of such shares to the shareholder, then the value should be deemed to be equal to the lesser of

i) the aggregate of such price plus the sales charges previously paid by the shareholder to acquire such shares, or

ii) the actual cost of such shares.

Where there have been no partial redemptions there should be no difficulty in establishing the amount of the sales charges from the records of the mutual fund, however, where there have been partial redemptions this may be difficult, if not impossible.

If the shareholder is unable to determine the amount of sales charges paid by him in respect of any shares he holds on valuation day then it is

suggested that he be deemed to have paid the amount of sales charge he would have paid had he acquired such shares en bloc on valuation day.

CONCLUSION

34. The acceptance of the present White Paper proposal for the taxation of mutual funds will inflict upon hundreds of thousands of small investors in Canada, an unfair burden of the "tax load". It will force the withdrawal of millions of dollars of foreign capital presently available to Canada through mutual funds. Retirement savings plans and pension funds will be obliged to discontinue investing through mutual funds, thereby depriving them of the professional investment management obtained through the mutual fund route. Such proposal is inconsistent with the first aim of tax reform as enunciated in Section 1 of the White Paper.

35. The conduit treatment of mutual funds in the manner outlined in this brief will remove all such

inequities and present no additional technical or administrative problems.

36. It is, therefore, respectfully suggested this committee recommend:

- a) that conduit or flow-through treatment be made available to mutual funds which could be given by permitting mutual funds to elect to be treated as partnerships in somewhat the same manner as is recommended for closely-held corporations subject to the general requirements and conditions outlined in this brief, and
- b) that the value of shares of mutual funds on the valuation day referred to in the White Paper be determined in the manner described in paragraph 33 of this brief.

PART II

(CAPITAL GAINS TAX, FIVE-YEAR REVALUATION
AND CANADIAN INVESTMENT ABROAD)

2.1. Part I of this brief presents the views of the C.M.F.A. relating to those proposals contained in the White Paper which are of special concern to shareholders of mutual funds.

2.2. There are many other proposals contained in the White Paper which directly affect mutual fund shareholders as well as shareholders of other types of corporations but there are three areas of particular concern to mutual fund shareholders. The C.M.F.A. desires to record certain views relating to these areas which are as follows:

- a) the imposition of a capital gains tax,
- b) the five-year revaluation proposals, and
- c) the general discrimination against Canadian investment abroad,

CAPITAL GAINS TAX

2.3. The C.M.F.A. has previously* gone on record as opposing a capital gains tax in Canada and still takes this position. The more than 700,000 investors in mutual funds in Canada are, on the average, investors of comparatively modest means. The imposition of a capital gains tax will adversely affect this relatively large and important segment of our population.

2.4. Apart altogether from its direct effect on these hundreds of thousands of investors the introduction of a capital gains tax will have an adverse effect on the Canadian economy. Canada requires, and will continue to require for many years, vast amounts of capital for its economic development. The development of its resources will, of necessity, involve the taking of major capital risks. The introduction of a capital gains tax will discourage such risk-taking by individual Canadians and hence reduce needed capital investment.

* C.M.F.A. - Submission to The Royal Commission on Taxation.

2.5. The adjustment of the tax rate schedule for individuals proposed in the White Paper has the effect of applying higher rates of tax at levels of individual income lower than comparable levels in other countries which impose a capital gains tax, such as the United States. Under the White Paper proposals, for the middle income group in Canada, capital gains even on shares of Canadian widely-held corporations will therefore be taxed at higher rates than in other countries and the maximum rate of tax will apply at much lower levels of individual income.

2.6. In the view of the C.M.F.A. if a capital gains tax must be introduced at all in Canada it should be for all income groups at no higher rates than those currently applicable in the United States, and more generous averaging provisions should be accorded.

FIVE-YEAR REVALUATION

2.7. Since the preparation of the preliminary draft of this brief the Minister of Finance has

indicated that the Government is reconsidering the five-year revaluation proposal. The C.M.F.A. submits that such proposal should be abandoned. The arguments against it are clearly stated in the report forwarded to your Committee by the Minister of Finance on March 9, 1970 and do not require repetition at this point. The C.M.F.A. further submits that if this proposal is rejected entirely it is not necessary to substitute for it the taxation of accrued capital gains at death. The rates of estate tax and succession duties in this country are sufficiently high to provide adequate taxation of such gains at death.

FOREIGN INVESTMENT BY CANADIANS

2.8. Under the heading "Government Objectives" appearing at Section 6.8 of the White Paper it is stated:

"the proposals are designed neither to provide an incentive to Canadians to invest abroad nor to place a barrier in the way of their doing so."

2.9. The C.M.F.A. disagrees with this statement. In its view, the proposals, if accepted, would place substantial barriers in the way of Canadian investment abroad. The most serious of these barriers would be presented to pension and retirement savings plans which will be required to invest 90% of their assets in Canadian securities to retain their tax-free status.

2.10. It is also proposed that the whole amount of gains on the sale of foreign securities but only half the gains on the sale of shares of widely-held companies be included in income by Canadian residents. It is unrealistic to suggest that such a direct tax advantage to Canadians investing in shares of widely-held Canadian companies is not a barrier to Canadian investment abroad.

2.11. The C.M.F.A. does not disagree with the expressed goal of Government to encourage Canadians to own their industries. The pursuit of such a goal must, however, be attended to upon the basis of a realistic assessment of the requirements of Canadian investors and of the availability of sound Canadian securities.

2.12. If the proposals set forth in the White Paper requiring pension plans and retirement savings plans to invest 90% of their assets in Canadian securities are adopted this in itself should ensure that there is not an undue proportion of Canadian savings invested abroad.

2.13. Participants in pension and retirement savings plans enjoy a tax free benefit. Contributions are deductible from income for tax purposes, and the income of the plans are not taxed before the participants' retirement. In exchange for these tax advantages it has been customary for the Government to require that a certain proportion of pensions funds be invested in Canada and it is proposed to extend this to registered retirement savings plans. These tax advantages are not available to the ordinary investor relative to the investment of his additional savings outside such plans. These savings will already have been taxed, and the income from such savings will also be taxed. It is submitted that it is not reasonable for the Government to restrict the manner in which these funds are invested by imposing an additional tax burden if a portion of such savings is invested abroad.

2.14. There is no evidence that the investment by Canadians in foreign portfolio securities has harmed the economy of the country, nor is there any evidence that the economy of the country would have benefited if these investments had been made in Canada. In fact, portfolio investment abroad by Canadians can serve a useful purpose as a foreign exchange reserve. The availability for repatriation of funds invested in such portfolio securities and the profits made on them could prove useful in the future, in the event of a foreign exchange crisis.

2.15. If at any time it became necessary for the Government to discourage foreign investment by Canadians because of balance of payment problems, then remedial action could be taken at that time, either through the tax system or otherwise.

2.16. It is not unpatriotic nor is it contrary to the interest of the country for a Canadian investor to assess objectively the worth of any particular investment having regard to the following:

- a) the income return offered by such investment,

- b) the capital growth potential of such investment,
- c) the strength of security offered by such investment,
- d) the liquidity of such investment having regard to the size of his holdings in it, and
- e) the balance that such investment might bring to his portfolio, for example, the only way a Canadian can invest in certain industries in Canada is by investing in the shares of their foreign parent.

There is no moral or economic basis for discouraging this objective assessment.

2.17. It has been stated in part I of this brief that a mutual fund must always be in a position to redeem the shares of a shareholder at unit value. In order to be in a position to do this a mutual fund must remain liquid and operate within certain restraints. For example, it may not hold more than 10% of the shares of any one issuer. It requires active markets

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with large volume sales so that it can liquidate securities to provide funds for redemption without unduly influencing the market price. At the present time such markets are more frequently found in the United States than in Canada.

2.18. By maintaining a significant portion of portfolio investments in U.S. securities mutual funds can greatly improve their liquidity, thereby ensuring that they will always be in a position to meet redemptions, even if they are fully invested in equities. In the event of a substantial run on redemptions, the greater degree of liquidity of the U.S. markets would mean that U.S. securities would be sold first and Canadian securities markets would thus not be unduly disturbed.

2.19. In conclusion, therefore, the C.M.F.A. wishes to record that:

1. it opposes the introduction of a capital gains tax in Canada but if such a tax is imposed it should be for all income groups at no higher rates than those currently applicable in the United States,

2. it opposes the five-year revaluation proposal set forth in the White Paper and any taxation of accrued capital gains at death in substitution therefore, and
3. it opposes the application of a higher rate of tax on gains on Canadian portfolio investments abroad,

All of which is respectfully submitted for your consideration by

THE CANADIAN MUTUAL FUNDS ASSOCIATION

APPENDIX 1

DIVIDENDS FROM WIDELY-HELD CORPORATION

	Mutual Fund	Personal Tax Rate		
		30%	40%	50%
<u>Direct to Individual</u>				
Receives		100	100	100
Add: taxable credit		50	50	50
Taxable income		150	150	150
Total Tax		45	60	75
Less: creditable tax		50	50	50
Tax payable (recovery)		(5)	10	25
After-tax income		105	90	75
<u>Via mutual fund</u>				
Receives	100			
Add: taxable credit	50			
Taxable income	150			
Total tax @ 33-1/3%	50			
Less: creditable tax	50			
	<u>0</u>			
Available for distribution	100			
<u>Individual receives</u>				
Add: taxable credit		100	100	100
		50	50	50
Taxable income		150	150	150
Total tax		45	60	75
Less: creditable tax		50	50	50
Tax payable (recovery)		(5)	10	25
After-tax income		105	90	75

APPENDIX II

CAPITAL GAINS

ON INVESTMENT IN WIDELY-HELD CORPORATIONS

(White Paper P.56, para. 4.62)

		<u>Personal Tax Rate</u>		
	<u>Mutual Fund</u>	<u>30%</u>	<u>40%</u>	<u>50%</u>
<u>Individual</u>				
Capital gain		100	100	100
Less: $\frac{1}{2}$		<u>50</u>	<u>50</u>	<u>50</u>
Taxable amount		50	50	50
Tax Payable		<u>15</u>	<u>20</u>	<u>25</u>
After tax		<u>85</u>	<u>80</u>	<u>75</u>
<u>Individual through mutual</u>				
Capital gain	100			
33-1/3 tax	<u>33.33</u>			
Net gain	<u>66.67</u>			
Special dividend distributed to shareholder		66.67	66.67	66.67
Taxable credit		<u>33.33</u>	<u>33.33</u>	<u>33.33</u>
Gain		100	100	100
Less: $\frac{1}{2}$		<u>50</u>	<u>50</u>	<u>50</u>
Taxable gain		50	50	50
Tax		15	20	25
Tax credit		<u>33.33</u>	<u>33.33</u>	<u>33.33</u>
Net tax refund		<u>18.33</u>	<u>13.33</u>	<u>8.33</u>
Net gain after tax		<u>85.00</u>	<u>80.00</u>	<u>75.00</u>

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APPENDIX III

DIVIDENDS FROM CLOSELY-HELD CORPORATION

	Mutual Fund	Personal Tax Rate		
		30%	40%	50%
<u>Direct to Individual</u>				
Receives		100	100	100
Add: taxable credit		100	100	100
Taxable income		200	200	200
Total tax		60	80	100
Less: creditable tax		100	100	100
Tax payable (recovery)		(40)	(20)	Ø
After-tax income		140	120	100
<u>Via Mutual Fund</u>				
Receives	100			
Add: taxable credit	50			
Taxable income	150			
Total tax @ 33-1/3%	50			
Less: creditable tax	50			
Tax payable	Ø			
Available for distribution	100			
Individual receives		100	100	100
Add: taxable credit		50	50	50
Taxable income		150	150	150
Total tax		45	60	75
Less: creditable tax		50	50	50
		(5)	10	25
After-tax income		105	90	75

APPENDIX IV
CAPITAL GAINS
ON INVESTMENTS IN CLOSELY-HELD CORPORATIONS
AND FOREIGN SECURITIES

	<u>Mutual Fund</u>	<u>Personal Tax Rate</u>		
		<u>30%</u>	<u>40%</u>	<u>50%</u>
<u>Individual</u>				
Capital gain - fully taxable		100	100	100
Tax		<u>30</u>	<u>40</u>	<u>50</u>
Net after tax		<u>70</u>	<u>60</u>	<u>50</u>
 <u>Individual through mutual fund</u>				
Capital gain	100			
Tax at 50%	<u>50</u>			
Net distribution as dividend		50	50	50
Taxable credit		<u>25</u>	<u>25</u>	<u>25</u>
Taxable amount		75	75	75
Tax		22.50	30.00	37.50
Creditable tax		<u>25.00</u>	<u>25.00</u>	<u>25.00</u>
Net tax (refund)		<u>(2.50)</u>	<u>5.00</u>	<u>12.50</u>
Net after tax		<u>52.50</u>	<u>45.00</u>	<u>37.50</u>

Assumption

- 1) Par. 4.62 page 56 of the White Paper applies only to gains from sale of holdings in widely-held corporations, and
- 2) Capital gains on foreign investments and closely-held corporations realized by a Mutual Fund become an ordinary dividend from a widely-held corporation when distributed to the shareholders.

APPENDIX V
CANADIAN SOURCE INTEREST

	Mutual Fund	Personal tax Rate		
		30%	40%	50%
<u>Direct to Individual</u>				
Receives		100	100	100
Total tax		<u>30</u>	<u>40</u>	<u>50</u>
After-tax income		<u>70</u>	<u>60</u>	<u>50</u>
 <u>Via mutual fund</u>				
Received	100			
Total tax	<u>50</u>			
Available for distribution	<u>50</u>			
Individual receives		50	50	50
Add: taxable credit		<u>25</u>	<u>25</u>	<u>25</u>
Taxable income		<u>75</u>	<u>75</u>	<u>75</u>
Total tax		22.50	30.00	37.50
Less: creditable tax		<u>25.00</u>	<u>25.00</u>	<u>25.00</u>
Tax payable (recovery)		<u>(2.50)</u>	<u>5.00</u>	<u>12.50</u>
After-tax income		<u>52.50</u>	<u>45.00</u>	<u>37.50</u>

APPENDIX VI
FOREIGN SOURCE DIVIDENDS AND INTEREST

	Mutual Fund	Personal Tax Rate		
		30%	40%	50%
<u>Direct to Individual</u>				
Receives		85	85	85
Add: foreign taxes withheld		<u>15</u>	<u>15</u>	<u>15</u>
Taxable Income		<u>100</u>	<u>100</u>	<u>100</u>
Total tax		30	40	50
Less: foreign tax credit		<u>15</u>	<u>15</u>	<u>15</u>
Tax payable		<u>15</u>	<u>25</u>	<u>35</u>
After-tax income		<u><u>70</u></u>	<u><u>60</u></u>	<u><u>50</u></u>
<u>Via mutual fund</u>				
Receives	85			
Add: foreign taxes withheld	<u>15</u>			
Taxable income	<u>100</u>			
Total tax	50			
Less: foreign tax credit	<u>15</u>			
Tax payable	<u>35</u>			
Available for distribution	<u><u>50</u></u>			
Individual receives		50	50	50
Add: taxable credit		<u>25</u>	<u>25</u>	<u>25</u>
Taxable income		<u>75</u>	<u>75</u>	<u>75</u>
Total tax		22.50	30.00	37.50
Less: creditable tax		<u>25.00</u>	<u>25.00</u>	<u>25.00</u>
Tax payable (recovery)		<u>(2.50)</u>	<u>5.00</u>	<u>12.50</u>
After-tax income		<u><u>52.50</u></u>	<u><u>45.00</u></u>	<u><u>37.50</u></u>

APPENDIX VII
COMPARATIVE POSITIONS OF PENSION FUNDS
("P.F.") AND RETIREMENT SAVINGS PLANS
("R.S.P.") INVESTING DIRECTLY OR THROUGH
A MUTUAL FUND ("M.F.")

NATURE OF INVESTMENT	TAX POSITION OF MUTUAL FUND	POSITION OF PENSION FUND OR RETIREMENT SAVINGS PLAN		DIFFERENCE IN RETURN
		THROUGH MUTUAL FUND	DIRECT INVESTMENT	
1. Dividend from widely-held corporation Add Taxable Credit Taxable income Total Tax on M.F. @ 33-1/3% Less Creditable Tax	\$100.00 50.00 <u>\$150.00</u> 50.00 <u>50.00</u>		\$100.00	
Net tax Available for distribution	ϕ \$100.00	\$100.00		
2. Capital Gain on Shares of widely-held corporation Tax to M.F. Net Gain to M.F. Special Distribution to shareholder of M.F. Taxable Credit to P.F. or R.S.P.	\$100.00 <u>33.33</u> 66.67		\$100.00	
		66.67		
		ϕ		\$33.33
3. Dividend from closely-held corporation Available for distribution after tax and credits to M.F.	\$100.00 \$100.00		\$100.00	

4.	Capital gain on shares of closely-held corporation	\$100.00		\$100.00
	Tax on M.F.	<u>50.00</u>		
	Available for distribution to shareholders of M.F.	50.00	\$50.00	
	Taxable Credit to P.F. or R.S.P.		ø	\$50.00
5.	Canadian Source Interest	\$100.00		\$100.00
	Tax on M.F.	<u>50.00</u>		
	Available for distribution to shareholders of M.F.	\$ 50.00	\$50.00	
	Taxable Credit to P.F. or R.S.P.		ø	\$50.00
6.	Foreign Source			
	Dividends and Interest less foreign withholding tax	\$ 85.00		\$ 85.00
	Add withholding tax to income of M.F.	<u>15.00</u>		
	Taxable income of M.F.	<u>\$100.00</u>		
	Total tax on M.F.	<u>50.00</u>		
	Less foreign tax credit	15.00		
	Tax payable by M.F.	\$35.00		
	Available for distribution to shareholders of M.F.		\$ 50.00	
	Taxable Credit to P.F. or R.S.P.		ø	\$35.00

APPENDIX "C"

A SUBMISSION CONCERNING THE
WHITE PAPER PROPOSALS FOR TAX REFORM
AS THEY AFFECT
PENSIONS AND RETIREMENT SAVINGS PLANS

PRESENTED BY

Investors GROUP TRUST CO. LTD.

SUBMISSION BY INVESTORS GROUP TRUST CO. LTD.
ON THE GOVERNMENT'S PROPOSALS FOR TAX REFORM

In this brief Investors Group Trust Co. Ltd. will confine its comments to those parts of the White Paper which relate to pension plans and retirement savings plans.

We are convinced that pension provisions have not received the attention they deserve. If most of the White Paper proposals are implemented, the tax relief granted to those participating in registered pension plans will be the most important and valuable tax relief benefit remaining in the Income Tax Act. On the other hand, the discriminatory application of these tax privileges as between different classes of taxpayers will be the most serious inequity left in our tax legislation, and will substantially negate the White Paper's goal of achieving "a fair distribution of the tax burden based on ability to pay."

As we will demonstrate below, only a small percentage of taxpayers are presently able to take full advantage of the pension plan benefits contained in the Income Tax Act. The majority are excluded, either because they are self-employed, or controlling shareholders of their corporations, or because they work for firms that have not implemented a maximum benefit pension plan. It is particularly important therefore that all taxpayers be given an equal opportunity to provide for their retirement years on a tax-sheltered basis.

Comments in Sections 2.46 to 2.49 of the White Paper appear to support this point of view. In Section 2.46 the paper acknowledges that the tax deferral on savings invested in a pension

or retirement savings plan is "a great advantage over having to save a similar sum out of income from which tax must first be paid out", and it estimates that this tax advantage can as much as double the amount of a person's after-tax retirement income. Section 2.47 establishes the necessity of conferring this valuable tax benefit "on an equitable basis, available to all." In Sections 2.48 to 2.50 the government expresses its belief that a system should be established that will accomplish this, but then follows with the statement that "revenue considerations prohibit a switch at this time".

There is no doubt that the revenue costs of pension tax concessions are very large. The tax-sheltered contributions and earnings of registered pension plans in Canada already exceed 2.3 billion dollars per year. This is more than 10% of the total taxable income of all Canadian individuals. It goes without saying that the ensuing tax revenue loss results in a higher tax rate being applied to the income remaining in the tax base. Naturally this also includes the income of persons who must provide for their retirement with after-tax dollars. It is for this reason, that this most important tax privilege must be extended to all taxpayers if the objectives of the White Paper are to be fulfilled and equity and neutrality are to exist in our tax system. The additional costs would be small in comparison with the existing revenue loss from this tax concession.

In the attached Statement I we illustrate the extent of the inequities in the present system. It shows that 60% of all taxpayers are not obtaining any tax benefits at all from the pension provisions in the Income Tax Act. Of the remaining 40%, some 852,000 public sector employees, who represent only 13% of all taxpayers, are enjoying more than half of the present tax

relief benefits. Particularly noteworthy is the fact that one-third of the total benefit, more than 3/4 of a billion dollars per year, is being obtained by the 4% of taxpayers who are members of the two largest federal government superannuation plans.

One of the main reasons for this disparity is that few private employers can afford to offer, as part of remuneration, pension benefits which are as generous as those provided to civil servants. All Canadian taxpayers should therefore be given the option of providing comparable benefits on their own on a tax-sheltered basis.

We challenge the statement in Section 2.50 of the White Paper that "The present contribution limits should be sufficient over a period of years to produce, along with the Canada Pension Plan and the old age security pension, reasonable retirement incomes." This simply is not so. The federal Civil Service Superannuation Plan presumably provides pensions which are not in excess of "reasonable retirement incomes." Using this plan as a model, we have calculated the cost of providing a comparable level of retirement income, assuming that a taxpayer begins his savings program at various ages between 25 and 60. Statement 4 demonstrates that in no case will the maximum Section 79B contributions provide anything close to a "reasonable retirement income."

Also using the federal superannuation plan as a model, we have prepared Statements 2, 3 and 4 to demonstrate the magnitude of the costs involved in providing a reasonable level of retirement income.

Statement 2 sets out a profile of a person's earned income during his working lifetime and compares this with the

income that he will need during his retirement years. It shows that the amount of money he will receive in retirement will be greater than his total earnings during the 35 years prior to retirement.

Statement 3 calculates the amount of money needed to purchase a pension at age 60. It shows that the costs range from a minimum of \$103,698.00 for a \$7,000.00 annual pension, to a maximum of \$661,240.00 for a \$40,000.00 pension.

Statement 4 calculates the annual contributions needed to provide a 70% pension. It shows that if salaries continue to increase at 6% per annum as they have over the past several years, and if we assume a 6% annual return on the invested monies, a person must set aside 30% of his earned income every year for 35 years in order to fund this type of pension. Much larger contributions are needed if the program is started at a later date. This statement also shows that the lump sum purchase cost of the 70% pension is more than 10 times the annual earnings on which the pension is based.

When these costs are compared with the maximum allowable deductions for pension and retirement savings plan contributions under the Income Tax Act, it is evident that the present provisions of the Act are inadequate for most taxpayers. They are also discriminatory in that they allow a minority of taxpayers to accumulate substantial pension benefits on a tax-sheltered basis, yet deny similar treatment to others. We respectfully submit that this situation should be corrected. We further submit that the changes should form part of the present tax reform package and should not be postponed until "revenue considerations" permit.

Our specific recommendations are as follows:

SPECIFIC RECOMMENDATIONS

1. Every taxpayer should be accorded the right to tax-shelter enough of his earnings during his working lifetime to provide an adequate level of retirement income for himself and his spouse during their retirement years. We would define an "adequate level of retirement income" as 70% of his best five consecutive years' earnings, plus some provision for post-retirement escalation to offset the effects of inflation.

2. The fact that a taxpayer is a shareholder, a partner or the sole proprietor of a business or professional practice should not affect his right to tax-shelter his earned income from these sources for retirement purposes.

In order to assist in the implementation of these recommendations we have set forth, in an appendix to this report, an outline of a simple, practical plan for your study and consideration.

CONCLUSION

In this brief we have described the discrimination inherent in the pension provisions of the Income Tax Act and have demonstrated the need for change. We have made some specific recommendations which, if adopted, will ensure a much fairer distribution of the tax burden among different classes and categories of taxpayers. We have also outlined a practical plan for implementing some of our major recommendations.

In closing, we will demonstrate below that our proposals

and recommendations will advance the principle goals of tax reform which are listed in Section 1.6 of the White Paper:

- (a) "a fair distribution of the tax burden" - We have shown that our recommendations will go a long way towards accomplishing this goal.
- (b) "steady economic growth and continuing prosperity" - Our recommendations will prove very beneficial in this respect. They will encourage savings and capital formation. Indeed, savings should increase by at least double the revenue cost of these proposals.
- (c) "the recognition of modern social needs" - The need for an adequate retirement income is gaining increased recognition as one of our more pressing social needs.
- (d) "wide spread understanding of and voluntary compliance with tax laws" - Voluntary compliance can only be achieved if taxpayers feel they are being treated fairly by the government. It is therefore particularly important to ensure that no class of taxpayer enjoys important tax benefits unless these benefits are available to all. Our recommendations are aimed at accomplishing this.

APPENDIX

The following is an outline of a plan for implementing some of the recommendations in the main body of our submission.

Main Objective

The main objective of this plan is to permit any individual to provide a reasonable level of retirement income on a tax-sheltered basis. For the purposes of this example, a reasonable level of retirement income has been taken to be a pension, at age 60, of 70% of his best five consecutive years of earned income. The maximum amount of pension that could be provided on a tax-sheltered basis would be limited to \$40,000 per year for someone reaching age 60 this year, although this \$40,000 limit would be tied to the national wage index and would thus increase proportionately in future years.

Description of Plan

Section 79B of the Income Tax Act should be amended and enlarged to permit a taxpayer to claim a tax deduction for contributions to a final earnings type R.S. plan, (hereinafter referred to as a "Special R.S. Plan"). There would be a limit on the maximum value of the plan, which could not exceed the amount needed to fund a pension, at age 60, of 70% of the planholder's best five consecutive years' average earnings. There would be no yearly limit on contributions -- the full cost of the pension could be funded at any time, without regard to the total number of years a person had spent in the work force.

Assumptions Used

If the plan is to be administratively feasible, the new Section 79B must be simple and readily understood. This requires adoption of some fixed assumptions plus some corrective devices to take care of discrepancies as they arise. The main assumptions are as follows:

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(1) That the rate of investment return of the fund will be equal to the rate of increase in the taxpayer's best five consecutive years' average earnings. This is not an unreasonable assumption, and it has the further advantage of allowing both factors to be ignored in the actuarial valuation of the plan, since they would cancel each other out.

(2) That the lump sum cost of a pension at age 60 is fifteen times the yearly income to be provided. This figure will allow for a widow's benefit and should also provide some protection against inflation during the post-retirement years.

Main Proposal

The foregoing principles and assumptions have been combined into the proposal that any person should be allowed to set up a Special R.S. Plan and claim a tax deduction for any amount contributed to the Plan as long as:

(a) The total value of the plan (after the payment) does not exceed the lesser of ten times the average of his best five consecutive years' earnings to date, or \$600,000 in any event, and

(b) The value of all other registered pension or retirement savings plans in which the taxpayer is interested is to be taken into account in valuing the amount of the Special R.S. Plan.

To illustrate how the plan will work, a 40 year old person, whose best five years' average earnings to date are \$10,000, could establish a Special R.S. Plan with a maximum present value of \$100,000

(10 x \$10,000), minus the amount of his other pension or R.S. plans.

If the Special R.S. Plan and his average income both increase at the same rate in future, the fund will never exceed ten times his earnings, and it will purchase approximately a .70% pension for him at age 60.

The \$600,000 maximum limit will restrict the pension to a maximum of \$40,000 per year.

Correction of Variances That Will Arise

Variances that arise after implementation of the plan can be corrected as follows:

(1) If the rate of increase in the planholder's average earnings outpaces the investment return of the fund, the total value of the fund will drop below ten times earnings and additional contributions can then be made to bring it up to maximum.

(2) If the growth rate of the fund exceeds the planholder's rate of increase in earned income, a surplus will arise in the fund. To take care of this, a fund valuation will be required every five years. If the value of the fund exceeds ten times earnings, the excess must be brought into the planholder's income for tax purposes. Section 43 should be applied to tax such amounts, unless some overall averaging provisions are incorporated into the Income Tax Act.

Note that these overvaluations can only arise in two ways: through excess investment earnings or, as will be dealt with later, through the accumulation of pension benefits in other plans during the intervening period. In both of these instances it would be equitable to tax the planholder on these increments in the particular period during which they were acquired.

Procedure where the taxpayer is covered under other registered pension plans or R.S. plans.

Where a planholder has an interest in other registered plans, the maximum limit of his Special R.S. Plan should be reduced by the value of these other interests. This can be accomplished as follows:

- (a) Other R.S. Plans - The total cash surrender value of all such plans owned by a planholder should act to reduce the maximum limit of his Special R.S. Plan. In the odd case where there is no cash surrender value, the wording in Section 300(2)(b) of the Income Tax Regulations could be used to determine the present value of the plan.
- (b) Money Purchase Pension Plans - In these cases the total amount sitting to the taxpayer's credit, either absolutely or contingently, would be deducted in arriving at the maximum amount of his Special R.S. Plan. This means that unvested amounts will also act to reduce the maximum amount of his private plan.
- (c) All other pension plans - The total pension benefits accrued to date, including unvested benefits would be ascertained. The present value of these benefits can then be calculated by using the rules set out in the Estate Tax Act for the valuation of deferred life annuities. The amount thus arrived at will be deducted in calculating the maximum limit on the Special R.S. Plan.

Additional Suggestions re Administration of Special R.S. Plans

If the foregoing proposal is to be acceptable to the Tax Department officials, it will have to entail a minimum of administrative difficulty. To this end, we have added the following suggestions:

(1) The obligation for providing all information needed to make the above calculations must fall on the taxpayer.

(2) There must be a certification by the taxpayer that all of his known interests in other pension and R.S. plans have been fully revealed.

(3) The plan administrator or trustee should certify that the figures used in calculating the maximum value of the Special R.S. Plan have been verified by direct reference to source information (such as other pension plans).

Translation of this Plan into Legislation

The legislative changes would follow along these lines:

First, an amendment would be required to add a new paragraph (c) to Section 79B(5) of the Income Tax Act. This paragraph would permit the deduction of any amount paid into a Special R.S. Plan, to the extent that the total value of the plan, (after making the payment) did not exceed a maximum limit as specified by Regulation.

Section 79B(6a) would also be added. This subsection would provide that the Special R.S. Plan must be valued at least every five years, and that any excess over the maximum limit of the plan (as specified by Regulation) must be brought into the taxpayer's income in the year. An amendment to Section 79B could allow any amount thus included in income to be withdrawn tax-free from the fund.

Section 43 of the Income Tax Act would be amended so that it applies to amounts included in income by reason of Section 79B(6a) of the Act.

A new Income Tax Regulation would provide a calculation of the maximum limit on Special R.S. Plans. This limit would be calculated as

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ten times a taxpayer's best five consecutive years' earned income to date, or \$600,000 whichever is lesser. The latter figure would be tied to a wage index.

The Regulations would go on to state that where the taxpayer was a member of other R.S. plans and/or registered pension plans, the value of such plans (as calculated hereunder) would be deducted in arriving at the maximum limit of the Special R.S. Plan. The calculation of the value of other registered plans would be as follows:

(a) For R.S. plans, wording similar to that used in Section 300(2)(b) of the Regulations would be adopted.

(b) For money purchase pension plans, the amount would be the value of all vested and unvested amounts sitting to the credit of the taxpayer, as certified by that pension plan.

(c) For all other pension benefits, the amount would be the present value of the pension benefit earned to date as calculated under the rules set forth in the Estate Tax Act for deferred life annuities.

Alternative Application

The plan as described above allows a taxpayer to fund the whole of his retirement plan at any time, regardless of his age or years spent in the work force. Alternatively, funding could be spread over the taxpayer's working lifetime.

This can be accomplished by reducing the maximum limit of the R.S. plan by the percentage that the planholder's age span to age 60 is of 35 years. In other words, a 46 year old person would have his plan limit reduced by $14/35$, or forty percent.

Statement 1

ANALYSIS OF TAXPAYERS
COVERED BY
REGISTERED PENSION PLANS

	<u>Taxpayers Covered</u>		<u>Annual Contributions and Investment Earnings</u>		<u>Total Value of Funds</u>	
		%	(millions)	%	(millions)	%
<u>PUBLIC SECTOR PLANS</u>						
<u>Per Public Accounts of Canada:</u>						
Public Service Superannuation						
Account	200,000		\$ 389		\$ 3,178	
Armed Forces	90,000		362		3,023	
	290,000	4%	\$ 751	32%	\$ 6,201	33%
<u>Per D.B.S. Reports - Trusteed Funds:</u>						
Federal Crown Corporations	110,800		154		1,031	
Provincial	107,200		110		735	
Municipalities	145,400		136		838	
Educational	190,300		177		969	
TOTAL PUBLIC SECTOR	843,700	13%	\$1,328	57%	\$ 9,774	52%
<u>PRIVATE SECTOR PLANS</u>						
<u>Trusteed, per D.B.S.</u>						
Religious & Charitable	10,200		\$ 12		\$ 88	
Health	46,600		28		140	
Trade & Employee Assoc.	900		1		6	
Co-operatives	13,400		9		56	
Industry	1,030,700		702		5,104	
Other	400		1		3	
<u>Insured Plans, & Gov't. Annuities</u>	<u>728,000</u>		<u>252</u>		<u>3,780</u>	
TOTAL PRIVATE SECTOR	1,830,200	27%	\$1,005	43%	\$ 9,177	48%
TOTAL, ALL PENSION PLANS	2,673,900	40%	\$2,333	100%	\$18,951	100%
TAXPAYERS NOT COVERED BY PENSION PLANS	4,000,000	60%				
TOTAL TAXPAYERS (per White Paper)	6,700,000	100%				

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Statement 2

Comparison of Earnings during a person's working lifetime
with post-retirement income similar to that provided by
the Federal Civil Service Superannuation Plan

Earnings during working lifetime
(assuming a 5% income progression)

Income during retirement years
commencing at 70% of final 6 years' average
earnings, progressing at 2% per annum,
one-half payable to widow (who is
assumed to be 5 years younger)

<u>Age</u>	<u>Earned Income</u>	<u>Age</u>	<u>Pension</u>
25	\$ 2,000	60	\$ 6,539
26	2,100	61	6,670
27	2,206	62	6,803
28	2,316	63	6,939
29	2,432	64	7,078
30	2,554	65	7,220
31	2,682	66	7,364
32	2,816	67	7,511
33	2,957	68	7,661
34	3,105	69	7,814
35	3,260	70	7,970
36	3,423	71	8,129
37	3,594	72	8,292
38	3,774	73	8,458
39	3,963	74	8,627
40	4,161	75	8,800
41	4,369	76	8,976
42	4,587	77	9,156
43	4,816	78	9,339*
44	5,057	79	4,763
45	5,310	80	4,858
46	5,576	81	4,955
47	5,855	82	5,054
48	6,148	83	5,155
49	6,455	84	5,258
50	6,778	85	5,363
51	7,117	86	<u>5,470</u>
52	7,473		
53	7,847	TOTAL RETIREMENT INCOME	<u>\$190,222</u>
54	8,239		
55	8,651		
56	9,084		
57	9,538		
58	10,015		
59	<u>10,516</u>		
TOTAL EARNINGS	<u>\$180,774</u>		

* NOTE: The pensioner in this example is assumed to have a life expectancy,
at retirement age, of 18 years. His widow is assumed to outlive him
by 8 years.

Statement 3

Statement Showing the Estimated
Cost, at age 60, of Purchasing
Different Levels of Retirement Income

<u>Initial Annual Pension (increasing 2% each year)</u>	<u>Amount of Investment needed to Provide this Pension at age 60, assuming:</u>	
	<u>(a) 5% Interest</u>	<u>(b) 6% Interest</u>
\$ 7,000	\$115,717	\$103,698
10,000	165,310	148,140
15,000	247,965	222,210
20,000	330,620	296,280
25,000	413,275	370,350
30,000	495,930	444,420
35,000	578,585	518,490
40,000	661,240	592,560

NOTE: The above figures are based on the following estimated costs of a \$1.00 per annum unit of pension:

Cost per \$1 unit, assuming a 5% interest yield - \$16.531

Cost per \$1 unit, assuming a 6% interest yield - \$14.814

These costs include provision for a widow's benefit and a post-retirement pension increase of 2% per year.

Statement 4

Calculation of the cost of producing
a "reasonable retirement income",
assuming the contribution program is
begun at various ages

Age at Commencement of Program	Percentage of earnings which must be contributed each year until age 60	Amounts which must be contributed each year, assuming earnings of			
		\$ 7,000	\$ 10,000	\$ 20,000	\$30,000
25 yrs.	30%	\$ 2,100	\$ 3,000	\$ 6,000	\$ 9,000
30	35%	2,250	3,500	7,000	10,500
35	42%	2,940	4,200	8,400	12,600
40	52.5%	3,675	5,250	10,500	15,750
45	70%	4,900	7,000	14,000	21,000
50	105%	7,350	10,500	21,000	31,500
55	210%	14,700	21,000	42,000	63,000
60 (lump sum purchase)	1,050%	73,500	105,000	210,000	315,000
Maximum Section 79B Contributions	20%	1,400	2,000	2,500	2,500

NOTE: The above calculations are based on the following assumptions:

1. That a "reasonable retirement income" is that provided by the federal civil service plan: a pension at age 60 of 70% of final earnings, with a 2% per annum post-retirement escalation clause. The pension also provides a 50% widow's pension in the event of the pensioner's death.
2. The pensioner is assumed to be married to a wife five years younger than himself.
3. Interest earnings on invested monies are assumed at approximately 6%.
4. Increases in pre-retirement earned income are assumed at 6% per year. This covers both promotional increases and increases in the general wage index. This is generally in line with the actual average experience over the past 25 years, although well below current levels of wage increases.

APPENDIX "D"

TEXACO CANADA LIMITED

SUBMISSION

RE

THE TAX REFORM PROPOSALS OF THE GOVERNMENT OF CANADA

APRIL, 1970

Standing Senate Committee

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SUMMARY AND RECOMMENDATIONS

Texaco Canada Limited (hereafter sometimes referred to as Texaco) welcomes this opportunity of expressing its views on the White Paper proposals for tax reform in Canada. The Company's interest lies in two main areas.

1. The direct impact on the Company's operations and its shareholders (PART A).
2. The effect of the proposals on the general economic and social development and prosperity of Canada which to a large extent will determine the Company's future success, (PART B).

Particular attention has been paid in the preparation of this submission to the direct impact of the proposals on the company's operations. The company's position and its reasons therefor are developed at greater length in PART A of this submission.

PART B is an expression of the Company's views on proposals of the White Paper which would likely have only a limited direct effect on the company but could have a substantial indirect effect by their impact on the environment in

which the company functions. We fear that the economy would be adversely affected by: a shortage of investment funds; inability to attract and keep skilled, well-educated employees, due to high Canadian tax rates versus those prevailing elsewhere; high unemployment due to industry's inability to compete with foreign producers; and excessive inflation due to the encouragement to Canadians to spend their earnings rather than save. More complete discussion of the economic effects has been left to others. In this regard we specifically endorse the economic views of the Canadian Manufacturers' Association as expressed in their brief to this Committee.

Even though the proposals will receive the best possible scrutiny by the most knowledgeable people in their particular fields it is difficult to predict with reasonable certainty what the effect on the social and economic life of Canada would be. For this reason changes in the tax system should be kept to a minimum and should be made only when provisions of the present statute are found to be seriously wanting and alternative proposals are found which will clearly result in improvements. In our view most of the key proposals do not represent improvements over the existing system and in fact many have serious drawbacks rendering them clearly inferior to the present system, consequently, such proposals should be rejected or substantially revised.

In summary, our recommendations respecting the portion of the White Paper discussed in this submission are as follows:

1. The proposed restriction of the gas and oil well operator's depletion allowance should not be adopted because this would inhibit the growth of the industry to the detriment of Canada both economically and sociologically. The present system should be revised to permit the deduction of an allowance that would produce an effective tax rate competitive with that prevailing in the U.S. (Page 9)
2. The present depletion allowance on oil and gas royalty income should continue to apply. (Page 15)
3. Depletion allowances available to shareholders of resource companies should not be cancelled, especially if the proposed system of taxing shareholders is implemented, because the corporation should be able to pass its depletion and other allowances to its Canadian resident shareholders, otherwise such allowances would largely be nullified in the hands of individual shareholders. (Page 18)

4. The proposed system of classifying corporations into groups and integrating all or a portion of corporation tax with that payable by shareholders should not be implemented as proposed. Among its many faults is its discrimination against shareholders of resource-based corporations that would result from such a procedure.

To correct these faults we suggest that consideration be given to exempting from further tax dividends paid by Canadian Corporations.

Alternatively, the present system of providing dividend tax credits and appropriate depletion allowances to Canadian resident shareholders should be retained in preference to the proposed integration system. (Page 19)

5. The proposal to eliminate the category of "nothings" which has plagued taxpayers for years is commendable and should be implemented. The denial of a deduction for any legitimate expense incurred to earn income cannot be justified. (Page 26)

6. The proposals to amend capital cost allowance regulations to require the establishment of a separate class for each rental building costing in excess of \$50,000 would be particularly onerous for companies with many retail outlets and should not be implemented for this type of business activity. (Page 28)
7. The proposal to disallow rental property operating losses which arise from taxes, interest and capital cost allowance should not be adopted because it would also be unfair and would impose an onerous administrative burden on the petroleum marketing industry. (Page 28)
8. Greater emphasis should be placed on the use of the tax system to encourage economic growth. (Page 30)
9. Tax levels should be competitive with those of competing countries and the level of government expenditures should be maintained within the limits of revenue provided by such tax rates. (Page 34)
10. A tax on capital gains should not be imposed at this time because of its adverse effect on capital

accumulations, saving and risk-taking as well as its tendency to increase inflationary pressures. However, if such a tax is deemed necessary substantial changes should be made to the proposals to reduce its punitive impact on the economy. (Page 37)

TEXACO CANADA LIMITED

Texaco Canada Limited is a fully integrated oil company, engaged either directly or through subsidiary companies in the exploration for, production and refining of crude oil and natural gas and distribution of petroleum products throughout Canada.

The Company owns and operates refineries located at Halifax, Montreal, Port Credit and Edmonton with a combined rated capacity of about 130,000 barrels of crude oil per day. The company distributes its products throughout Canada through approximately 4,600 retail outlets, most of which are operated by lessee dealers. During 1969 the Company's sales of petroleum products averaged 141,709 barrels daily.

At the end of 1969 the company had working interests of 246 net producing oil and gas wells in Western Canada. Its net production, including royalty received, averaged 18,580 barrels per day during 1969.

The Company had 3,481 employees at the end of 1969 of whom practically all are Canadian citizens.

Approximately 68% of Texaco Canada's stock is

owned by Texaco International Financial Corporation, a wholly owned U.S. subsidiary of Texaco Inc., New York. The remaining 32% of the stock is widely distributed, mainly among Canadian investors.

DEPLETION ALLOWANCES RESPECTING OIL AND GAS INCOME

The White Paper acknowledged the necessity of providing incentives to the mining and petroleum industries because of the unusual risks involved in such enterprises and because of their contribution to regional development, particularly in Canada's frontier areas. Nevertheless, it proposed to reduce the incentives now available.

The White Paper, quite correctly, pointed out that the present depletion allowance incentive to operators tends to work against itself by requiring the deduction of exploration expenses from the depletion base. As exploration increases the depletion allowance is reduced. The proposal of the government, however, would not correct this fault; instead it would add a second limitation to that presently existing in the form of the 3 for 1 proposal of paragraph 5.40.

We submit that the purpose of a depletion incentive is and should be to encourage investors to risk their capital in the industry. An efficient and effective incentive is one which rewards the successful investor in the form of a reduced tax burden on income. In our view an investor earns the right to depletion on future income realized from his investment at the time when he assumes the risk by making the investment. To suggest that the investor must continue to earn it, as does the White Paper, is unfair.

The White Paper proposals, which would require a taxpayer to earn the right to depletion on the basis of \$1 for every \$3 of eligible expenditures would not be an incentive but would, as we said previously, place a second limitation on the amount of depletion which may be claimed. The White Paper concept of "earned" depletion may be described more accurately as a penalty provision rather than an incentive. From the viewpoint of operational planning this concept is not feasible. Exploration effort must be geared to the investor's capital, technical and human resources, geological prospects, and expected economic returns. Exploration expenditures must be incurred wisely, after careful study and planning. There could be extended periods during which geological prospects available would not warrant carrying on an active program. During such periods investors should not be penalized on the grounds that they did not "earn" depletion allowances. To reiterate, the right to the allowance is earned when the exploration investment is made.

The proposal would constitute an increase in the company's tax burden applicable to producing operations of up to 50% in excess of present levels. The precise amount of the increase would vary from year to year, depending upon exploration and development expenditures, but over the long term it would be substantial. The resultant effective tax rate, when the new proposals were fully in effect, would be much

higher than the effective rate prevailing in the U.S. and most other countries of the world actively competing for oil development capital. Canada would, therefore, be clearly at a disadvantage in attracting such capital. Further, capital generated from internal sources would be reduced because of the increased tax burden. Consequently the industry's growth would likely be impeded to the extent that it would be prevented from making the maximum potential contribution to the economic progress of Canada.

The oil industry has made huge investments in Canadian oil exploration and development during the last two decades on the assumption that a depletion allowance of one-third of production profits would be available when profits were realized. A change in the rules which would reduce or eliminate depletion on income arising from such investments would constitute a form of retroactive taxation which, according to paragraph 1.12, the White Paper seeks to avoid. The proposed five year transition period would be grossly inadequate to prevent retroactivity.

The White Paper appears to have overlooked the direct financial contributions the producing industry in Canada has made to various federal and provincial public treasuries as well as the indirect contribution to the entire Canadian economy.

Since the discovery of the Leduc field in 1947 the industry has contributed in excess of \$3½ billion to governments for royalties and petroleum rights leasing costs. Provincial governments, mainly of the province of Alberta, have been the chief recipients, but in view of recent discoveries it is reasonable to expect that if adequate incentives are provided the federal government will receive substantial sums in the future. These sums represent a substantial portion of total industry expenditures and are unique to the petroleum industry. They represent amounts that would have to be raised by taxation if the industry did not exist. Although the company paid substantial sums in income taxes with respect to its producing operations in 9 of the last 10 years, it contributed between two and three times the income taxes paid for royalties and mineral lease payments to governments in the same period. For Texaco's producing operations during the ten year period, income taxes, royalties and mineral lease payments were equivalent to an effective tax rate of 51.5%.

Resources in the ground become useful only when they are discovered and developed. This represents a classic example of the creation of wealth. Governments do not create the resource-- they provide the climate for entrepreneurs to put their skills and physical resources to work to create wealth. The removal of, or a substantial reduction in, rewards

available to investors would inhibit the creation of wealth to the detriment of the investor and government alike.

It is difficult to know how far the tax collector can go in establishing tax rates which will maximize the return to governments. Too high a rate would blunt incentives resulting in lower tax revenues and, more importantly, a slower creation of wealth from which governments receive substantial revenue.

The best indicator should come from experience. Has the present system been successful? Has it attracted too much capital to the resource sector to the detriment of other sectors resulting in excess capacity in the resource sector and a shortage elsewhere? We submit that the present system has been moderately successful in attracting capital and other resources for the creation of wealth in the natural resource sector. Further, far from denying capital and other resources to other sectors, the multiplier effect of demand on the overall economy has attracted sufficient resources to other sectors that could produce a reasonable economic return. While there is some theoretical surplus crude oil production capacity in Canada at the moment, it is insufficient to meet expected increases in demand even in the relatively short term as is evidenced by the U.S. government's recent statements to the

effect that Canada lacks adequate surplus capacity to provide sufficient security for emergencies.

To encourage the industry to provide the necessary resources to search for and develop new reserves the present incentives need to be improved to provide effective tax rates which would be competitive with those prevailing in most other countries of the world competing for oil development capital, particularly the U.S. The lower effective rate in the U.S. and many other countries results from a combination of a higher depletion allowance and a lower corporate tax rate than prevails in Canada. Instead, the White Paper proposes a reduction in the present inadequate incentives. Adoption of this proposal would be against the national interest.

Texaco Canada and other members of the petroleum industry have, in the past, suggested that an efficient and effective depletion allowance would be one based on a percentage of producing revenue before deducting production and exploration expenses. We still hold this view. To provide an effective tax rate competitive with the U.S. rate a depletion allowance higher than the 22% prevailing in the U.S. would be required because the Canadian corporate tax rate is higher. A rate of about 25% would provide an effective rate that would be reasonably competitive with the U.S. and is therefore, the rate we recommend be adopted. The amount of the allowance

could be restricted to a reasonable percentage of net production income.

ROYALTY DEPLETION

The proposed cancellation of the depletion allowance on royalty income would also be a retrograde step. The royalty farmout agreement is but one alternative available to an enterprise engaged in petroleum exploration to achieve the development of the enterprise's property. We do not understand why the White Paper has singled out this type of arrangement for particularly harsh treatment.

An operator has several options available to him in developing mineral rights he holds under lease. He may commit his own financial and technical resources to their development, he may find a partner who is willing to share the cost and risk or he may "farm out" some portion of his rights to someone else while retaining some interest for himself. The farmout may take the form of a carried or net profits interest, whereby the farmee is required to carry out the development at his own cost and pay a portion of net proceeds from production to the farmor after the farmee recovers his costs. The farmor is considered to be an operator for depletion allowance computation purposes under the present rules.

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Another alternative available to the farmor is simply to retain a right to receive an overriding royalty on production derived from the property. This is a very common arrangement. The present depletion regulations permit an allowance of 25% of the amount received by the farmor.

In deciding which route to take an operator takes into consideration his resources available and the most appropriate areas of their employment as well as his assessment of the property as compared with that of a prospective farmee. The overriding consideration is, of course, to maximize the overall economic return to the farmor.

For all practical purposes the lessor of the mineral rights (farmor) is very much an operator regardless of the option he takes for the development of the property. We see no justification for cancelling the allowance on this particular type of arrangement.

Tax provisions should not discriminate against a particular type of arrangement that would be appropriate from an ordinary business point of view.

A change in the rules now would be discriminatory to properties previously committed to royalty agreements

because such action would have retroactive effect in reducing the economic returns of such prior arrangements.

The proposal to cancel the royalty depletion allowance is of great concern to Texaco Canada because of an arrangement made many years ago under which the company acquired royalty rights. Since that time the farmee carried on an active exploration program, including the drilling of several dry holes, which ultimately resulted in oil and gas discoveries, requiring the payment of substantial royalties to Texaco.

Texaco actively participated in exploration and development activities continuously since the early 1940's, many years before the discovery of the Leduc or Redwater fields. It has remained an operator throughout this period even on properties committed to the royalty agreement from which the company receives substantial income because it succeeded in bringing about the development of such properties.

If the proposal to cancel the allowance on royalty income was in effect in 1969 the additional tax cost to the company would have been about \$450,000. The cost in future years would be even higher because production from properties committed to the agreement continues to increase year by year.

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We recommend that the present depletion allowance applicable to royalty income be continued because it is computed at the same rate and in the same manner as we are recommending for other oil and gas income.

SHAREHOLDER'S DEPLETION

The cancellation of shareholders' depletion, coupled with the integration formula, would discriminate against shareholders of resource development companies because allowances passed to shareholders in the form of dividends would be taxed in their hands in full with no creditable tax offset. To make an incentive truly effective, it should be made available to the investor who provides the capital for development.

CORPORATIONS AND THEIR SHAREHOLDERS

Texaco Canada Limited is opposed to the White Paper's proposals for partial integration of the income taxes of widely-held corporations and their shareholders, for the reasons discussed hereunder.

The classification of corporations into two groups because of their supposed differences in relationships between the shareholders and corporations is arbitrary and, in any case, is not sufficient reason for taxing the two groups differently. Every corporation must have more than one shareholder, although usually several and frequently most of whom do not take part in the day-to-day operations of the company. This is equally true of many public and private companies, both large and small. Also, every company must answer to its shareholders and carry on its activities in such a manner that all shareholders' rights, including those of minority shareholders, are properly protected.

The further argument used to justify the division of corporations into two groups, i.e. closely-held corporations generally compete with partnerships and proprietorships; whereas, widely-held corporations compete with each other, is also invalid and irrelevant. Some of Canada's largest corporations

are closely-held but compete very effectively with widely-held corporations, which in many cases are much smaller. The unincorporated specialty shop competes in the same market place as the large department stores. This is equally true of most businesses in a related field regardless of their relative size or business structure.

The ability of shareholders of some closely-held corporations to take credit, when filing their returns, for taxes paid by such corporations coupled with the use of the partnership option would practically exempt such shareholders from further tax when the top marginal personal rate is reduced to 50%. Shareholders with personal top marginal rates lower than 50% would, in fact, receive refunds. On the other hand, shareholders of widely-held corporations would receive credit for only one-half of the tax paid by the corporation. This treatment would be discriminatory and unfair.

The requirement that creditable tax of a corporation be passed to its shareholders in dividends within 2½ years could put pressure on its board of directors to increase the dividend payout. If a company yielded to this pressure its growth could be severely restricted due to the probable lack of sufficient outside sources of capital at reasonable cost. The restriction could also have negative results for the Canadian

economy and impair the balance of payments with foreign countries because a substantial portion of the dividends could be paid to non-residents of Canada.

The procedure of issuing stock dividends to overcome the foregoing problem, as suggested by the White Paper, would not be an acceptable solution because it would involve unnecessary legal fees and other administrative costs and could have a disruptive influence on stock market prices. It would have the further disadvantage of requiring resident shareholders with marginal tax rates in excess of 33-1/3% to use personal cash resources to pay the additional tax on the stock dividends.

The principle that a shareholder's dividend is to be taxed in full through the gross-up procedure and credit granted for creditable tax is inequitable, especially to natural resource-based industries and public utilities. Tax incentives and accelerated allowances available to corporations, such as depletion and capital cost allowance, would be largely eliminated when passed to shareholders in the form of dividends because there would be no applicable creditable tax. Surely it is not sound policy to provide an incentive to a company and then tax it in the hands of its Canadian shareholders. It is interesting to note that this procedure is not nearly as punitive to foreign shareholders, which would tend to make

shares of such corporations relatively more valuable to foreigners than to Canadian residents.

The integration proposal is based on the assumption that the corporation pays tax on behalf of its shareholders. The White Paper argues that if the corporation pays no tax, shareholders should not receive any tax credit from their personal tax on dividends received. It appears to us more logical to argue that if there is no creditable tax it is because the corporation had no taxable income and therefore, this amount when transmitted to shareholders should continue to be free of tax. It follows that only taxable income to the corporation should be taxed to shareholders when distributed.

A simpler method of effectively implementing full integration and at the same time overcoming the inequities discussed above would be to simply exempt dividends paid to Canadian residents from further tax.

In summary, the integration proposal is illogical, unfair because it would discriminate against resource-based and growth potential industries and favour slow growth or declining businesses, could impair capital accumulations by corporations by encouraging dividend payouts against good business judgment and would be difficult and costly to administer and should, therefore, not be adopted.

The present system of a shareholder's depletion allowance coupled with a dividend tax credit is preferable to the government's integration proposal. Admittedly the system is not perfect but it does provide encouragement to Canadians to invest in Canadian corporations without discriminating against corporations that have no creditable tax and, also, it provides a mechanism for passing some of the depletion allowances granted to corporations on to their shareholders, thereby providing some measure of equity with non-natural resource based stocks.

PARTNERSHIP OPTION

As indicated above the company is of the opinion that the present rules relative to dividend payments are preferable to those proposed. However, a system of filing consolidated returns is desirable to permit the deduction of losses incurred by one or more members of a corporate group against profits of others. The partnership option proposal would be of some assistance in this regard but the restrictions proposed would limit its application unfairly and unnecessarily. We suggest that the proposed restrictions be eased to permit shareholders who collectively hold a majority of the shares to make the election. This privilege should be available to both widely and closely-held corporations. An administrative procedure could be developed whereby the corporation would pay its tax in the normal manner and the shareholder could take credit for his share of the tax paid.

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It is not clear that shareholders electing to adopt the partnership option will be deemed to have earned the income and incurred the expenses of the "partnership" corporation. It could be important to resource industry taxpayers to have such income and expenses treated as having been earned or incurred by the partners for purposes of computing depletion allowances.

This is of special interest to Texaco Canada because it and a wholly-owned subsidiary, Regent Refining (Canada) Limited, are both engaged in the production of oil and gas although only Texaco Canada is engaged in exploration activities. If the depletion computation must be made for each company individually, Texaco's consolidated tax burden could be adversely affected because one company may have substantial income while the other may incur a loss due to a heavy exploration program. This problem could be overcome by making the partnership election, provided such election would permit complete consolidation of oil and gas production income and exploration and development expenditures.

It is not possible under present corporation laws to merge Regent and Texaco because the former was incorporated as an Ontario company whereas Texaco was incorporated

under the laws of Canada. The transfer of Regent's assets to Texaco without incurring possible tax liabilities would be difficult to accomplish. It should be noted that the present depletion regulations require, under certain circumstances, the aggregation of associated companies' production income and exploration expenditures for depletion computation purposes.

A further item requiring clarification is the proposed treatment of unrealized intercompany profits if the partnership election is made. This is a matter of significance to Texaco Canada because some of Regent Refining's crude oil production is sold to Texaco Canada and vice versa. A full consolidation of the two companies' operations by the use of the partnership option would require the elimination of unrealized profits from intercompany sales and purchases. We recommend that this procedure be permitted.

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BUSINESS AND PROPERTY INCOME

"NOTHINGS"

Texaco agrees with the proposal to allow the deduction of "nothings" which have heretofore been disallowed even though they were incurred to earn income. In view of this welcome change in the thinking of the Department of Finance it is difficult to understand why it proposed to create a new class of nothings for such items as business conventions and entertainment expenses.

The present Act provides safeguards against abusing the privilege of deducting such expenses. If the government is of the opinion that there is widespread abuse of the present system it should institute an improved administrative procedure to enforce the provisions of the present Act. Surely any necessary or reasonable expense laid out to earn income should be deductible.

CAPITAL COST ALLOWANCES

Texaco is concerned at the hints in the White Paper that the government considers the present capital cost allowance system generous to taxpayers with the implication that such allowances will be reduced after a further review is undertaken.

We believe the present system has served Canada and taxpayers well. It has undoubtedly encouraged investment in new plants and modernization of old to improve efficiencies to the mutual benefit of taxpayers and the government. Such incentives are no less necessary now than in earlier years because Canada is still a relatively undeveloped country requiring enormous investments to achieve its productive potential.

We believe it is significant that the present Act and Regulations grant an allowance "in respect of the capital cost" of property. There is an unfortunate tendency for many to assume that the intent of the legislation is to permit the write-off of an asset over its estimated useful life in conformity with the ordinary accounting concept of depreciation for profit reporting purposes. We believe that the capital cost allowance concept was intended to provide an incentive to businesses to modernize and expand, recognizing that in most instances the write-off of assets for tax purposes would provide a larger deduction in early years than would be reflected in the accounts.

A higher write-off in early years was further justified by the fact that the business must invest an amount at the beginning of a project for which it would receive tax relief only over an extended period in the future. In view of the high cost of money the value of tax relief in the future

is not worth nearly as much as the same amount in the year in which the investment is made. Consequently, businesses requiring heavy capital investment would suffer a disadvantage if they were forced to use the straightline accounting depreciation concept in computing taxes. The present system, which allows a higher write-off in early years, provides some relief from this inequity.

The present regulations could be improved by making some changes to provide for current needs but these are of a relatively minor nature and do not require a revision of the system.

RENTED PROPERTIES

The Company, like its competitors in the petroleum marketing industry, owns or leases numerous service station properties throughout Canada, which are leased to dealers. The purpose of these properties is, of course, to provide sales outlets for the Company's products. Rental income received, particularly in the case of new outlets, may be insufficient to cover all costs such as capital cost allowance, interest and property taxes.

We see no justification for denying the company an immediate deduction for the rental loss on properties which

is obviously an expense incurred to earn taxable income. This proposal appears to be a case of inadvertently penalizing some taxpayers to stop what the department considers an abuse of the system by a few.

The disallowance of losses respecting rental properties, aside from the inequity of the principle, would presumably require the preparation of a taxable income or loss computation for each property. Such a requirement would be extremely onerous to the point of absurdity.

The requirement that a separate capital cost allowance class be established for each rental building costing in excess of \$50,000 would also be an unfair and unnecessary burden on the petroleum marketing industry. This would require a separate class for virtually every service station constructed by the industry in recent years.

OBJECTIVES OF A TAX SYSTEM

The White Paper listed five goals of tax reform- viz.: a fair distribution of the tax burden based upon ability to pay; steady economic growth and continuing prosperity; the recognition of modern social needs; understanding of and voluntary compliance with tax laws; the elimination of loopholes; and the acceptance of the system by the Provinces.

Texaco agrees in general with the stated aims of tax reform but disagrees with their emphasis and has serious doubts that the proposals would facilitate the accomplishment of the objectives. The Paper has apparently completely rejected the "benefits received" concept of taxation.

The primary aim of a tax system in raising government revenue requirements should be the encouragement of economic growth. The paper points out that taxes impede enterprise but a good tax system should minimize its interference with incentives to work and invest. We agree with this statement and submit that the best means of minimizing interference is to minimize the tax burden. If the tax burden on workers and investors in Canada were less than on their counterparts in countries with whom we

are in competition for manpower and capital resources, chiefly the U.S., Canada would be given a competitive edge for the attraction of such resources to the country's long term benefit.

Interest rates are traditionally maintained at higher levels in Canada than in the U.S. to attract capital to this country. Similarly, if lower levels of personal and corporate taxation prevailed in Canada a competitive advantage would be given to Canada in attracting manpower, technical know-how and other resources for the development of the Canadian economy. As a consequence, national wealth would be increased and the tax base broadened to provide greater revenue for governments to finance social requirements.

If the government's calculations of revenue yields are borne out, then, such a policy may require some immediate sacrifices in government services because taxation revenues would be curtailed in the early period. These sacrifices would be small in relation to the long term benefits that would be realized.

The White Paper proposes a completely opposite policy to what is necessary. Instead of providing for taxes lower than those in the U.S. the Paper proposes

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to widen the gap which already exists for most categories of taxpayers, particularly since the enactment of the U.S. Tax Reform Act of 1969.

Complete acceptance of the "ability to pay" approach and the rejection of "benefits received" concept penalizes success and efficiency, and conversely, subsidizes failure and inefficiency. It would be a mistake to use the tax system as the economic equalizer to the point where incentives to work, save, invest, learn, innovate and assume risks are blunted.

Naturally we do not expect persons of meager means to make a significant tax contribution to the public treasury. The point we wish to make is that the ability to pay concept in the tax system should not be relied upon to too great an extent in the country's social security program. Greater emphasis should be placed on incentives to individuals and businesses to expand and create new wealth, thereby creating employment opportunities and generally broadening the tax base.

The adoption of the White Paper proposals would, in our opinion, fall far short of the stated objective of promoting steady economic growth and continuing prosperity.

The erosion of savings through increased taxation; reduced economic returns on investments; disincentives to work, save and invest in Canada; reduced inflows of foreign capital; discouragement to prospective immigrants to come to Canada and encouragement to Canadians to emigrate; would impede economic growth.

It appears that the stated objective of eliminating "loopholes" was given priority in the White Paper. Unfortunately measures proposed on the grounds that they are necessary to correct abuses of the present tax system tend to distort their effect on other operations. The tendency to over-kill would create more inequities than would be corrected. In our view, the present Act provides ample statutory authority which, when diligently applied administratively as it has been in recent years, eliminates most abuses.

RATES OF TAX

As indicated above, the proposed rates of taxation could be injurious to the Canadian economy because they are not competitive with those of our major international neighbours. Canada is already faced with disadvantages in manufacturing due to limited resources, (such as capital, technical, etc.) a smaller market requiring shorter production runs, and substantial distribution costs. When taxes, too, are non-competitive the odds against Canadian producers become very high.

We note that Canada's population growth rate has been on a steady decline for many years and there is no indication of this trend being reversed in the immediate future. Canada must, therefore, increasingly rely on upgrading the skills of its residents for the country's development. The discrepancy in tax rates coupled with higher salaries and living standards in the U.S. would make it increasingly difficult for Canada to retain its valuable human resources and to attract others from abroad. The "brain drain" would be accelerated. The White Paper conceded that on the face of it this could be a problem but concluded that U.S. immigration difficulties and more favorable social conditions in Canada would provide the necessary checks to keep Canadians at home and attract immigrants to Canada. The paper also suggested that higher salaries

could be offered to key people to keep them in Canada or bring them from abroad.

It would be a mistake to accept the above arguments and assume that Canada would not be faced with an accelerated "brain drain". Many people find Canada's climate and social conditions far from ideal. U.S. immigration difficulties for many are not a serious obstacle and in any event are not likely to continue indefinitely. The suggested solution of higher salaries would be self-defeating. While it may be practical to single out a few individuals for special treatment without serious disruption to the operation and profitability of an enterprise, it could not be done on the scale required. High salaries in selected groups would tend to set standards for other persons with comparable skills to maintain morale within the company. High wage scales would reduce profits and impair the company's competitive position. Industry would tend to move to the U.S. rather than try to function in the high-cost Canadian economy.

It is imperative that Canada's personal and corporate taxes be competitive. Canada's decision to raise a stated amount of revenue from its taxpayers, regardless of the consequences, would be irresponsible. Although the action may meet the immediate objective of providing for the government's concept of the country's current requirements, it would have the

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long-term effect of eroding the tax base due to the economy's failure to achieve its full potential.

The White Paper proposes to make the "temporary" surtax a permanent feature of the system and add a few more percentage points in critical areas. In contrast, the U.S. has decided to eliminate its surtax, increase its exemptions and generally reduce overall personal taxes.

The proposed increase in personal exemptions in Canada is commendable. However, it only partially restores the value of the exemptions originally established in 1949, which through inflation have been seriously eroded. We also agree with the proposal to establish a top marginal rate of 50% and hope that provincial pressures and future revenue requirements will be resisted to permit the maintenance of this rate. As indicated above, we are seriously concerned at the heavy burden which the proposed rates would place upon the middle and upper income groups and the consequent adverse long-term effects on the economy.

THE TAXATION OF CAPITAL GAINS

As indicated at the beginning of this Part of the submission, Texaco believes that the primary aim of tax policy should be the promotion of economic growth. This objective will not be achieved unless a high rate of private savings in Canada and substantial foreign investment continues.

The Sixth Annual Review of the Economic Council of Canada, released in 1969, reported that Canada must rely on a continued high rate of savings to achieve its growth potential because the very heavy world demand for capital will make it difficult for Canada to attract large amounts of foreign capital.

Reduced economic incentives in Canada, which would be brought about by increased taxation as proposed by the White Paper, would further reduce Canada's competitive position in attracting foreign capital. The taxation, or even the threat of taxation, of capital gains realized or deemed realized by foreigners on Canadian investments could very seriously inhibit foreign investment in this country.

The taxation of capital gains would reduce private savings substantially, as would probable increased dividend payouts to preserve tax credits to shareholders and the proposed

increases in tax rates. We believe the White Paper underestimated the probable reduction because there is no evidence that taxpayers attitudes have been taken into account. We expect many taxpayers, if not the majority, after paying higher taxes, would tend to dispose of their remaining income on consumer goods and services because incentives to save would be reduced. The tax on gains, arising from personal savings, when combined with recently revised gift and estate taxes would constitute powerful inducements to spend rather than save.

We fear that capital would not be available in sufficient amounts at reasonable rates to permit the Canadian economy to expand sufficiently to reach acceptable employment levels and approach maximum potential output.

Texaco Canada, therefore, believes that a capital gains tax would be inappropriate at this stage of the country's economic development.

The tax as proposed would have the following additional unfortunate results:

- (1) Corporations could be pressured into increasing dividend payouts to prevent tax credits from becoming staledated and to reduce capital gains, frequently contrary to good business practices.

- (2) The movement of personnel across the border on temporary assignments would be inhibited to Canada's economic disadvantage. An efficient, highly-industrialized economy requires the free movement of skilled personnel across international boundaries. The deemed realization of gains upon a taxpayer's departure from Canada would discourage a person from leaving the country for a short period and others from entering on similar assignments.

- (3) The taxation of deemed realizations of gains respecting widely-held corporations every five years would be unfair and it could force sales of substantial interests at inopportune times which may result in serious market disruptions. Also, contrary to past government policy, the taxation of deemed realizations would discourage foreign controlled Canadian closely-held corporations from offering share ownership to Canadian investors.

- (4) In many cases apparent increases in value of property represent only inflationary gains. A true gain may be measured only in terms of constant dollars. A tax on inflationary increases

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would be unjust because it would constitute confiscation of capital, not a tax on income.

- (5) The practical problems associated with valuing taxpayers' assets on valuation day in a manner that would be acceptable to both the taxpayer and tax collector several years hence are almost insurmountable. Because values of most types of property cannot be determined with any degree of precision until a willing buyer is found and a sale actually consummated, the possibility of all taxpayers being treated equitably is remote.
- (6) The taxation of gains realized or deemed realized after Valuation Day would require the payment of tax even in instances where no gain was realized because the original purchase price was higher than the realization. This would be particularly common if Valuation Day occurred when the securities market was depressed.
- (7) The proposal to tax foreign shareholders on quinquennial unrealized gains of Canadian widely-held corporations and realizations from certain sales is likely not possible under present international agreements, would be extremely difficult

to enforce and is unlikely to be acceptable to any foreign country in future agreements. It is most unfortunate that the proposal was ever made because it will have only undesirable results in raising foreign investors' anxiety and suspicions with negative effects on the Canadian economy.

- (8) The taxation of capital gains realized on the sale of residences could "lock" some taxpayers into arrangements inappropriate to their circumstances. To many salary or wage earners the investment in residences often represents a substantial portion of their life-long savings. Taxation of accumulated gains re-invested over a period of years through the rollover provisions could render potential capital gains taxes so severe that disposals to facilitate moves to more suitable climates on retirement, or a change in circumstances otherwise, would be inhibited.

When Canada reaches a stage of economic development whereby capital requirements of a full employment economy may be provided at reasonable rates from private savings it may be appropriate to introduce a tax on capital gains. Such a tax should be imposed gradually and should be much less severe than proposed by the White Paper to soften

its negative impact on the economy. We note that the Royal Commission on Taxation's proposal to tax capital gains, when taken together with its "integration" and income averaging procedures, would in many cases be less severe than that now proposed.

Texaco recommends that if at some future date it is appropriate for Canada to impose a tax on capital gains the following specific amendments to the White Paper proposals be made to lessen its punitive impact.

- (1) The rate should be substantially lower, not in excess of 25%.
- (2) A more realistic system of averaging should be permitted. The system of block averaging proposed by the Royal Commission on Taxation would be much fairer.
- (3) The gains should be adjusted by an index, similar to the national cost of living index, to determine the true gain in terms of constant dollars.
- (4) Gains arising from the sale of personal objects and hobby items should be exempt because tax enforcement on such property would be impractical.

Also, because these items represent consumption goods they should be exempt.

- (5) The rollover privilege should be extended to business property acquired to replace existing property. This procedure would remove penalties that may otherwise apply to growing businesses which find it necessary to move to new locations for expansion purposes.

- (6) The tax should not apply to a taxpayer's principal residence because it would inhibit taxpayers adjusting their accommodation to suit their needs and would provide a further obstacle to home ownership.

Also, a person's residence is a consumption rather than investment item, as pointed out by the White Paper in refusing to permit the deduction of losses or carrying charges on residences from other income. Profits should therefore not be taxable.

- (7) The quinquennial valuation and taxation proposal relative to the shares of widely-held Canadian Corporations should be abandoned. Tax should apply only upon the sale of such shares. The "lock in" argument advanced by the White Paper

to justify the quinquennial valuation would apply equally to shares of closely-held corporations which the paper wisely proposes to exempt from periodic valuation. This taxation proposal is inequitable and unjust.

- (8) To remove pressure on corporations to distribute a larger portion of earnings than is justified on the basis of sound business judgment, increases in share values relative to re-invested earnings should be deducted from the gain in computing the amount subject to tax.
- (9) Taxpayers should have the option of deducting the cost or valuation day value of assets from proceeds in computing taxable income.
- (10) To minimize the administrative problems of distinguishing income from capital transactions a holding period of about six months should be established. Transactions which under the present practice would be tax exempt (e.g. stock market trading) should be considered as ordinary income taxable at full marginal rates if the assets were held for less than six months, whereas they would be taxable at capital gains rates if held

longer. The present rules should be applied to transactions to determine those that are taxable at full rates regardless of the length of the holding period (e.g. land transactions).

- (11) Serious consideration should be given to abolishing the estate tax as the capital gains tax becomes fully effective to avoid the imposition of a double tax on savings. This point was very well made by the Ontario government in their 1969 budget, concluding that the estate tax should gradually be eliminated.

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APPENDIX "E"

THE WHITE PAPER ON TAX REFORM

INVESTMENTS OF PENSION FUNDS

BRIEF

BY

THE PENSION FUND SOCIETY OF THE
BANK OF MONTREAL

OUTLINE

- I - Synopsis of organization submitting brief.
- II - The objectives of Canadian pension fund administration.
- III - Background considerations relating to the administration of Canadian trustee pension funds.
 - A. Growing significance of pension fund costs to Canadian employers and employees.
 - B. Importance of investment returns in meeting pension fund costs.
 - C. Trend to equities in Canadian pension funds in order to improve investment returns.
 - D. Imbalance in supply of, and demand for, Canadian equities.
- IV - The taxation proposals and Canadian pension funds:
 - A. We believe that the proposed 10% foreign asset limitation is unduly restrictive. Bearing in mind that many pension funds have, as a short term objective, a proportion of assets in equities greater than 50%, our recommendation is that an asset limitation, if indeed one is necessary, should be not less than 20%.
 - 1. Past performance of Canadian and U.S. stock prices.
 - 2. Areas of above-average growth not meaningfully represented in Canada.
 - 3. The limited marketability of many Canadian equities.
 - 4. Diversification of equity investments among Canadian industries.
 - B. If a percentage of assets foreign investment limitation is enacted, we believe that it should be calculated on the basis of original cost values of securities in portfolios.
 - C. We believe a reasonable time period should be allowed to comply with a new foreign asset limitation and are in favour of a four-year period.

I. Synopsis of The Pension Fund Society of the Bank of Montreal

The Pension Fund Society of the Bank of Montreal was established in 1884 and incorporated by Special Act of Parliament in 1885, succeeding an Annuity and Guarantee Fund Society originating in 1861.

Membership in the Society, which is contributory, is confined to male managerial and clerical employees, but the Bank for many years granted retiring allowances to other long-service employees. In October, 1967, the latter system was converted to a formal funded plan under the Pension Fund Societies Act (1952) as The Second Pension Fund Society of the Bank of Montreal, becoming fully operative in April, 1968. However, as the new Society is young, this Brief refers specifically to the older Society, although it has general application also to The Second Society.

Membership in both Societies is mandatory for permanent, full-time employees, subject in certain groups to age or service qualifications. Employees who are members or potential members number about 5,000 and 13,000 for the old and new Societies respectively.

As the present Brief deals with pension fund investment aspects of the White Paper, it is pertinent to note that The Pension Fund Society held mainly fixed income securities until the middle 50s, when a progressive programme of investment in common stocks was instituted, with the proportion of such holdings reaching 35% (book value) and 47% (market value) of total assets at 31st December, 1969, approximately half in the United States, with highly satisfactory results.

II - The Objectives of Canadian Pension Fund Administration

In our opinion, the objectives of Canadian pension fund administration are to maximize the level of pension benefits and minimize the cost of these benefits to Canadians, with due consideration being given to other national goals in seeking to achieve these objectives. An important supplementary consideration is that Canadian pension benefits should remain competitive with those of other countries in order to retain, and build, a superior work force.

III - Background Considerations Relating to the Administration of Canadian Trusteed Pension Funds

A) Growing Significance of Pension Fund Costs to Canadian Employers and Employees

At the end of 1968, Canadian trusteed pension plans* had assets of \$8,972 million in terms of book value and slightly less in terms of market value, largely because of the 12-1/2% decline in market value of bonds from book value in recent years which has slightly more than offset the 30% appreciation from book value of the much smaller amount held in equities. Of the nearly \$9 billion total amount, more than half was accounted for by Industrial pension plans. Unlike the situation in the United States, where pension plans are largely non-contributory, Canadian employees contributed \$306 million to trusteed pension plans in 1968, or slightly more than one-third of total contributions.

Employer contributions have shown a compound annual growth of 10.5% in the 1960-68 period, and this rate appears to be accelerating as a result of solvency requirements in federal and provincial pension legislation obligating employers to fund deficits within specified periods of time. These deficiency and past service payments are likely to continue to grow rapidly as other provinces effect similar pension legislation. The great importance of pension costs to employers can be seen in the following table which shows the significant size of these costs in relation to pre-tax profits for several large Canadian and U.S. companies.

*In Trusteed Pension Plans Financial Statistics 1968 prepared by the Dominion Bureau of Statistics, from which data on Canadian pension plans contained in this brief has been taken, a trusteed pension plan is defined as "an arrangement under which the contributions to a pension plan are deposited with a trustee (which may be one or more persons, a trust company or a pension fund society) who is responsible for holding and investing contributions, as well as the payment of benefits, in accordance with the terms of a trust agreement."

T A B L E 1.

<u>Company</u>	1968 Pretax Profit <u>(\$ million)</u>	1968 Pension Costs <u>(\$ million)</u>	1968 Percent Pension Costs to Pre- tax Profits
<u>Canadian</u>			
Alcan Aluminium	138.8	13.1	9.4%
Bell Canada	216.6	13.7	6.3%
Steel Co. of Canada	105.4	12.5	11.9%
<u>U.S.</u>			
Reynolds Metals	40.4	13.0	32.2%
U. S. Steel	353.7	70.2	19.8%
General Electric	669.4	50.5	7.5%

Source: Annual Reports

B) Importance of Investment Returns in Meeting Pension Fund Costs

A growing realization of the burden of pension costs has led many corporations to review the management of this highly important part of their over-all operations, particularly since in certain instances total pension fund assets may represent as much as one-third to one-half of the firm's total investment in plant and equipment. Today, considerable emphasis is put on professional investment guidance in recognition of the fact that a 1% improvement in investment return can produce over thirty years a 20% reduction in costs, or a 25% increase in benefits. To the extent a reduction in costs is achieved, a larger corporate and/or personal tax base results. Appendix A illustrates the importance of obtaining an adequate return on investment in financing pension benefits.

C) Trend to Equities in Canadian Pension Funds in Order to Improve Investment Returns

As a consequence of the recognition that even small improvements in yield can, over a long period of time, have a substantial impact on the operations of the pension fund, there has been in many instances a marked shift away from fixed income securities towards equities, where higher total yields, comprising dividends and realized and unrealized capital gains, have been available. Nevertheless, equity holdings by Canadian pension funds, which have been most heavily emphasized in industrial companies and Crown Corporations, are considerably below the levels achieved by United States pension funds.

T A B L E 2.

Percentage of Total Trusteed Pension Fund Assets Held in Common Stocks				
		1960	1968	
		Book Value	Market Value	Book Value Market Value
Canadian Plans				
Industry				
Section only (a)	9.9%	NA	28.7%	37.2%
U.S. Plans				
Private (b)	32.2%	42.5%	50.2%	62.5%

(a) Excludes investment in pooled pension funds, which, if included, might add 4% to 1968 book and market value percentages.
Source: Dominion Bureau of Statistics

(b) Includes funds of corporations, non-profit organizations, and multi-employer and union plans.
Source: United States Securities and Exchange Commission.

The disadvantages of this relatively lower level of equity investment are recognized by Canadian pension fund managers, but since bond market conditions in recent years have precluded any large-scale disinvestment of bonds at economic prices, they have been restricted to channeling the bulk of cash flow into equities. Nevertheless, the

amounts involved have been very substantial, both in absolute dollar amounts and in their relationship to net new issues of Canadian common and preferred stocks.

T A B L E 3.

THE INVESTMENT BY CANADIAN TRUSTEED
PENSION PLANS IN EQUITIES - 1964-1968,
AND NET NEW ISSUES OF CANADIAN EQUITIES

(a)

Canadian Trusteed Pension Plans

<u>Net Increase in Book Values</u>	<u>1968</u>	<u>1967</u>	<u>1966</u>	<u>1965</u>	<u>1964</u>
	(\$ million)				
Cdn. Common & Pfd. Stocks	280	219	179	198	144
Non-Cdn. Common & Pfd. Stocks	184	106	71	43	43
Total Assets	904	818	709	775	639
Cdn. Stocks as % of Total	31.0%	26.8%	25.3%	25.5%	22.6%
Non-Cdn. Stocks as % of Total	20.3%	13.0%	10.0%	5.5%	6.7%

(b)

Net new issues of Cdn. Common & Preferred shares	564	504	595	474	438
Pension fund Cdn. equity purchases as a per cent of net new issues	49.6%	43.5%	30%	41.8%	32.9%

Notes: (a) Pension fund investments include estimates of equities purchased through pooled funds.

(b) The net new Canadian issues figure for 1964 was adjusted to exclude the effect of the non-recurring payment of \$115 million for B.C. Electric Co. shares by the Province of British Columbia.

Sources: Dominion Bureau of Statistics; Bank of Canada Statistical Summary, December, 1967 and December, 1969 issues.

Although purchases of foreign common stocks rose steadily throughout the period and accelerated quite sharply in 1968, if the trend evident from statistics

for the first nine months of 1969 is true of pension fund investment behaviour generally, the rate of increase declined quite sharply last year.

D) Imbalance in Supply of, and Demand for, Canadian Equities

In view of the trend toward increased equity investment by Canadian pension funds, a final background consideration should be, in our opinion, the prospective imbalance in the supply of and demand for Canadian equities, which has been the subject of considerable recent study, most notably by Professor Conway of York University for the Toronto Stock Exchange, and by D.H. Fullerton and C.J. Starrs in a 1967 report to the sub-committee on the Structure of Canadian Industry. These studies predicted a substantial excess of demand over supply for Canadian equities during the 1970's, the word "substantial" inferring approximately double. If anything, we believe these estimates are likely to prove conservative, in the light of additional factors which may now be cited. For example, it seems likely that proposals contained elsewhere in the White Paper regarding the preferential treatment of capital gains on shares of widely held Canadian companies will increase their attractiveness to taxable investors and therefore the demand for them.

In addition, it appears altogether likely that the as yet insignificant equity holdings in Government public employees' and teachers' retirement plans in Canada may be increased significantly in the years ahead, to judge from experience recently revealed for the United States, as contained in Appendix B. This development would act to increase further the demand for Canadian equities.

IV - THE TAXATION PROPOSALS AND CANADIAN PENSION FUNDS

In the White Paper on Taxation dated November 7th, 1969, it was stated that in view of the size and rate of growth of pension and retirement savings funds, due in part to their tax-free status, it is reasonable to require that the bulk of them be productively invested in Canada. It was therefore proposed that to qualify for tax-free status, these plans must invest no more than 10% of their assets in foreign securities or other investments.

- A. We believe that the proposed 10% foreign asset limitation is unduly restrictive. Bearing in mind that many pension funds have, as a short term objective, a proportion of assets in equities greater than 50%, our recommendation is that an asset limitation, if indeed one is necessary, should be not less than 20%.

Although, in general terms, we believe that unrestricted capital markets are in the long term interests of Canada, and complete freedom of investment action is in the long term interests of trustee pension plans, nevertheless we recognize that Canada's position as a chronic importer of capital may require temporary restrictions on these freedoms. While we appreciate that a case can be made for a limitation on foreign asset investments by pension funds, serious problems, with respect to costs, benefits and investment management, will follow from the 10% limit suggested, which far more than outweigh any possible benefits from legislating such a low figure.

It is our belief that by the mid-1970's Canadian Industrial Pension Plans are likely to have over 50% of their total assets invested in common stocks. If this is the case, then on the basis of the proposed 10% foreign asset limitation at least 80% of the common stock portfolios would have to be in Canadian stocks and not more than 20% in foreign stocks. Over the five years to 1968 the average annual growth of Industrial trustee plan assets was 14%. If one assumes that this rate of growth will continue, as we believe it will, total assets in Industrial plans will increase, in terms of book value, from \$5.1 billion at the end of 1968 to \$12.8 billion by the end of 1975. Common

stock holdings could rise from \$1.5 billion to \$6.4 billion, for a fourfold gain, and even if the maximum is invested in foreign securities at the proposed 10% limitation, Canadian common stock holdings would have to increase by \$4 billion, from the \$1.1 billion at the end of 1968 to \$5.1 billion at the end of 1975. The total investment in foreign securities could increase only by some \$950 million, from \$370 million at the end of 1968 to \$1.28 billion at the end of 1975. If Canadian Trusteed Pension plans are to be restricted to the domestic equity market to the extent required by the proposals of the White Paper, the following considerations, in our opinion, are important:

- 1) What has been the past performance of Canadian stock prices in general compared with U.S. stock prices;
- 2) What areas of investment, offering above-average growth, are not represented in Canada;
- 3) Do high growth Canadian equities possess adequate marketability; and
- 4) Can reasonable diversification be achieved in a large Canadian portfolio not only between different industries, but between cyclical and non-cyclical industries.

1. Past Performance of Canadian and U.S. Stock Prices

In Appendix C, the percentage changes in the Toronto Stock Exchange Industrial Index, and the subindices, are shown from 1956, when the subindices were first compiled, to the end of 1969. In Appendix D, comparable figures are shown for the Dow-Jones Industrial Average, which is heavily weighted by relatively mature industrial companies, and the more comprehensive Standard & Poor's main indices and the 102 subgroups.

These two appendices show that although the Toronto Industrial Index outperformed the Dow-Jones Industrial Average by one-third, the former was outperformed by

20% by the Standard & Poor's 425 Industrial Index. However, much more meaningful is that the Standard & Poor's subgroups shown below each outperformed the best-acting Toronto Stock Exchange subgroup, Merchandising, which rose by 241.4% over the 14 year period.

T A B L E 4.

<u>Standard & Poor's</u> <u>Subindex</u>	<u>1956-1969</u> <u>% Change</u>	<u>Standard & Poor's</u> <u>Subindex</u>	<u>1956-1969</u> <u>% Change</u>
Office & Bus. Equipment	+1,218.0	Air Conditioning	+ 365.2
Cosmetics (1957 base)	847.5	Packaged Foods	309.6
Electronics	841.5	Publishing	291.3
Drugs	624.9	Soaps	274.2
Soft Drinks	616.0	Retail - Mail order	270.4
Vending Machines	444.3	Variety Stores	264.9
Radio - TV Manufacturers	370.5	Electrical Equipment	251.6
Radio - TV Broadcasters	365.7	Textile - Apparel	246.4

Source: Standard & Poor's Trade and Securities Statistics, 1968.

2. Areas of Above-Average Growth Not Meaningfully
Represented in Canada

Unfortunately, investment opportunities in Canadian stocks are very limited in the above groups. In relatively senior electronic companies there is Leigh Instruments; in soft drinks, Crush International; in vending machines, Versafood Services; in TV manufacturers, Electrohome Limited and Fleetwood; in publishing, Thomson Newspapers, Southam Press and MacLean-Hunter; in retail mail order, Simpson-Sears; and in variety stores, Zeller's. Our pension fund holds stock of only two of the above Canadian companies, and both holdings are relatively small, in large part because of the difficulty of acquiring stock other than in block transactions. To give an example, the total volume of the 10 issues noted above traded on stock exchanges in Canada and New York in 1969 was only slightly more than \$100 million, or about 25% more than the total annual trading

volume of Moore Corporation or the Bank of Montreal, and of the \$100 million, nearly one-third was represented by the publishing stocks. However, indicative of the fact that institutions will buy these stocks, when available, at prices considered to be attractive, was the recent private placement with institutions of 475,000 shares of Thomson Newspapers.

The Bank of Montreal Pension Fund holdings of U.S. stocks in the above groups are, however, substantial, as shown in the following table which gives the portfolio representation of each of the groups, expressed as a percentage, by book value, of the common stock portfolio.

T A B L E 5.

<u>U.S. Industries</u>	<u>Percentage of Total Equity Portfolio by Book-Value</u>	<u>% Market Appreciation over Book Value</u>
Office & Bus. Equipment	8.0%	+ 84%
Cosmetics	3.1	+ 24
Drugs	2.4	+ 47
Soft Drinks	2.0	+ 23
Radio-TV Manufacturers	1.2	- 39
Air Conditioning	1.0	+172
Soaps	2.0	+ 32
Retail - Mail Order	1.3	+ 18
Variety Store	0.9	+423
Photographic (not in- cluded in Standard & Poor's subindices)	<u>5.1</u>	+ 20
	<u>27.0%</u>	

Taken together these U.S. holdings, with the possible exception of Radio-T.V. manufacturers because of Japanese competition, possess strong secular growth characteristics, and are not meaningfully represented in Canada. In the aggregate they account for 27.0% by book value and 32.4% by market value of the equity holdings of the Bank of Montreal Pension Fund. Since virtually half the

total pension assets by market value of the Bank of Montreal last year were in common stocks, the 32.4% represented 16.2% of total assets. Excluded from this list are such strong secular growth industries as electronics, packaged foods, electrical equipment and stocks in the rapidly growing leisure market, for which meaningful Canadian representation is not available, as well as many high quality U.S. cyclical stocks which, from time to time, have exceptional investment merit.

On this basis, and bearing in mind that many pension funds have, as a short-term objective, a proportion in equities greater than 50%, our recommendation is that an asset limitation, if indeed one is necessary, should be not less than 20%.

In the case of the Bank of Montreal Pension Fund such a limitation would still have required, last year, a reduction in the percentage of assets, by market value, held in foreign securities. Our equity portfolio, which during 1969 reached approximately 50% of total market value assets, was, at October 31, 1969, 46.0% invested in foreign (U.S.) common stocks. However, while nearly half of the equities were in foreign stocks, only 3 of the 10 largest holdings, which amounted to 37.8% of the equity holdings by market value, were foreign issues. This, we believe, is indicative of the investment concentration required in a Canadian portfolio because of the limited marketability of many Canadian issues.

3. The Limited Marketability of Many Canadian Equities

Few pension funds presently have payments which exceed contributions, so that the need for a high degree of marketability of assets in order to meet payments is not yet a major consideration. However, a reasonable degree of marketability is necessary for investment reasons, not only for suitable industry diversification because of changing economic trends, but also because both industries and major companies can encounter operational difficulties of sufficient severity and duration to make it highly desirable that investment holdings be reduced or entirely eliminated. An example would be the Canadian Pulp & Paper Industry, which over-expanded capacity and

encountered pricing difficulties so severe that industry profits declined by 36% from 1964 to 1967 and the Toronto Stock Exchange Paper and Forest Products subindex declined 52% from September 1964 to March 1968.

What represents a reasonable degree of marketability depends on the size of the investment holding and investor attitudes to the shares in question. Regretfully, but factually, investors tend to act in unison, and what may normally be an actively traded stock may become essentially unmarketable if problems arise within the company.

Appendix E lists 106 Canadian stocks for which earnings growth has exceeded 10% annually over the last 5 years. Of the companies listed, only 52 had a trading volume calculated last year to have exceeded \$10 million, which on the basis of our own experience is the lowest volume level for a stock which under normal circumstances could be considered reasonably marketable.

The difficulty encountered by the large institution in attempting to establish meaningful positions in high growth Canadian companies can be illustrated by further analysis of data contained in Appendix E. As shown in Table 6 below, when the 106 companies are divided into four approximately equal groups, it becomes clear that the dollar value of shares traded tends to vary inversely with the earnings growth rate, meaning that as higher returns from Canadian companies are sought, it becomes increasingly difficult, because of the marketability limitation, to obtain them.

T A B L E 6.

<u>Number of Companies</u>	<u>Earnings Growth Rate Category</u>	<u>1969 Dollar Value of Trading on Canadian and New York Exchange</u> (\$ million)
26	10.1% - 13.4%	1,173.6
26	13.4% - 17.5%	596.8
27	17.5% - 27.8%	672.2
27	27.8% +	472.2

To the extent that the large Canadian pension fund may not be able to obtain the desired combination of high growth and marketability from Canadian equities, performance would seem likely to suffer as a result of a 10% foreign asset limitation being imposed.

Furthermore, of the total volume of \$2.9 billion, nearly 10% was represented by the trading volume of the Canadian Chartered Banks, which under existing regulations, our pension fund is not allowed to own. Our exclusion from this important area of investment, which has the second highest weighting of all the subgroups in the Toronto Stock Exchange Index, would clearly make our equity investment problem considerably greater than for non-bank Canadian companies if the 10% foreign asset limitation is legislated, and accordingly may deserve special consideration.

4. Diversification of Equity Investments Among Canadian Industries

An essential ingredient of successful equity investment management is a minimizing of exposure in cyclical industries prior to cyclical downturns in the economy, with correspondingly greater emphasis on secular growth companies whose profits tend to remain in an uptrend. Such secular growth companies are only modestly represented in the Canadian equity market, being included in such subgroups as Merchandising, Beverage, Food Processing, Bank, Trust & Loan, Utility, and Communications, which have an aggregate weighting in the Toronto Stock Exchange Index of 43% but, in our opinion, considerably less in terms of reasonably marketable issues. In Appendix F we have shown the performance of Canadian and U.S. industry stock price indices in periods when the Toronto Stock Exchange Industrial Index declined substantially. It can be readily seen that there was a substantial number of important U.S. industry groups which performed relatively well in four out of the five periods of decline. Among Canadian subgroups there have been extremely few that have managed to go against the broad downtrend, particularly if gold shares are excluded as being unsuitable for most long-term investment accounts, partly because of marketability.

We believe, therefore, that in terms of proper investment management it is essential for the managers of the Fund to have substantial holdings of secular growth stocks which are obtainable in size only in foreign markets. To restrict these holdings to not more than 10% of total assets could jeopardize the long-term investment results of the pension fund.

- B. If a percentage of assets foreign investment limitation is enacted, we believe that it should be calculated on the basis of original cost values of securities in portfolios.

Since it is recommended in the White Paper that to retain tax-free status, pension funds must invest no more than 10 per cent of their assets in foreign securities or other foreign investments, an important consideration is the manner in which the percentage of assets calculation would be made. While, as noted in Section IV (A), we believe that the Government's proposal to restrict foreign investments to 10 per cent of total assets is unduly restrictive, we feel that, if enacted, any proposed asset limitation calculation should be based on original cost values of securities in portfolios, and not market values or a revised cost value equivalent to market value on "Valuation Day."

Since the December 20th, 1960 Supplementary Budget speech by the then Minister of Finance which stated that to qualify for tax exemption a pension plan must derive at least 90 per cent of its investment income from Canadian sources, we have complied with this requirement. In so doing, it has been our practice to invest a substantial amount of the portfolio in high growth, low yielding foreign (primarily United States) stocks in areas not meaningfully represented in Canada. In large part, our expectations of obtaining high total returns on foreign equities have been realized. Based on experience over an eleven-year period, the results obtained with our U.S. common stocks have been better than with our Canadian equities, and, in turn, the latter have provided higher returns than fixed income securities, particularly in recent years. Reflecting this satisfactory performance, our U.S. investments are now worth, in terms of market value, a good deal more than their cost value, and at October 31st, 1969, foreign investments represented 17.5% of the total portfolio in terms of book value,

and 23% in terms of market value. It therefore follows that, if a 20% proposed foreign asset limitation were based on market values, or "Valuation Day" values, investment changes would be required to bring the portfolio into line, whereas under a limitation based on original cost values they would not.

In our opinion, the past success of efforts to invest our assets most productively, in complete compliance with Government policy, would be penalized to a greater extent if the foreign asset limitation were to be based on market or "Valuation Day" values rather than original cost values, and therefore, for this reason, we are in favour of the latter basis being used.

Second, from an investment decision-making point of view, an original cost rather than a market value based system of calculating foreign asset ratios is also preferable. Since market values can fluctuate quite widely over short periods of time, sales or purchases of foreign securities might have to be made in order to comply with an imposed asset restriction rather than for investment reasons alone, and this, in our opinion, would likely detract from overall investment performance. Because of this, original cost values would definitely be more practical to work with in administering pension fund investment decisions under the method proposed for limiting foreign investments.

Finally, it seems probable to us that a great many of the pension plans in Canada do not calculate market values on a regular (i.e., quarterly or monthly) basis, whereas original cost values of securities should always be known. The difficulty of determining market values for all types of assets appears to be recognized in other legislation, an example being the Pension Benefits Standards Act, which requires in periodic reports showing lists of assets, book values in all cases, and market values for bonds, debentures, and shares of capital stock only.

In summary, we believe that a pension fund could comply with a percentage-of-assets based foreign asset limitation more readily if it were related to original cost rather than market values.

- C. We believe a reasonable time period should be allowed to comply with a new foreign asset limitation and are in favour of a four-year period.

When the present restriction on Canadian Pension Fund foreign income was introduced in late 1960, a two year period was allowed to meet the new requirement. If a foreign investment limitation is legislated, based upon a percentage of assets calculation, we believe that a similar period of transition should be allowed, the length of which should depend upon the severity of the foreign asset percentage imposed. For reasons set out below, we favour a four-year transitional period.

It seems entirely possible to us that some pension funds will have invested in foreign industries at or near a cyclical peak, after which the market values of the securities purchased will have declined significantly from original cost. A current example is U.S. air transport common stocks, some of which we have in our portfolio. Furthermore, certain actuaries continue to deduct from, or add to, annual dividend and interest income, net capital profits or losses realized in order to arrive at their actuarial yields on which company contributions are based. Accordingly, if substantial net losses on sales of foreign securities are forced, the acceptance of these losses could distort actuarial yields. Therefore, in view of the long-term nature of the commitments being funded in the normal plan, which allows a long-term investment strategy to be undertaken, we believe that the typical pension fund manager would prefer to wait for the industry business cycle to run its course rather than sell the security in question at a substantial book loss.

Since it seems likely that the bulk of Canadian pension plan foreign assets are invested in U.S. equities, we believe it of interest to examine data compiled by the National Bureau of Economic Research in the United States on the average length of business cycle expansions and contractions in that country over long periods of time. This data is summarized below:

T A B L E 7.

<u>Average, all Cycles</u>	<u>Cycle Duration in Months</u>	
	<u>Trough from Previous Trough</u>	<u>Peak from Previous Peak</u>
26 Cycles, 1854-1961	49	49
10 Cycles, 1919-1961	50	54
4 Cycles, 1945-1961	46	46

Source: Business Conditions Digest, October, 1969.

Based on this data, we believe that a four-year transitional period would allow the bulk of foreign (i.e., U.S.) equities now in Canadian pension funds to be sold without substantial losses being incurred. We are, therefore, in favour of such a period being allowed for pension funds which now have foreign investments in excess of any asset limitation being imposed.

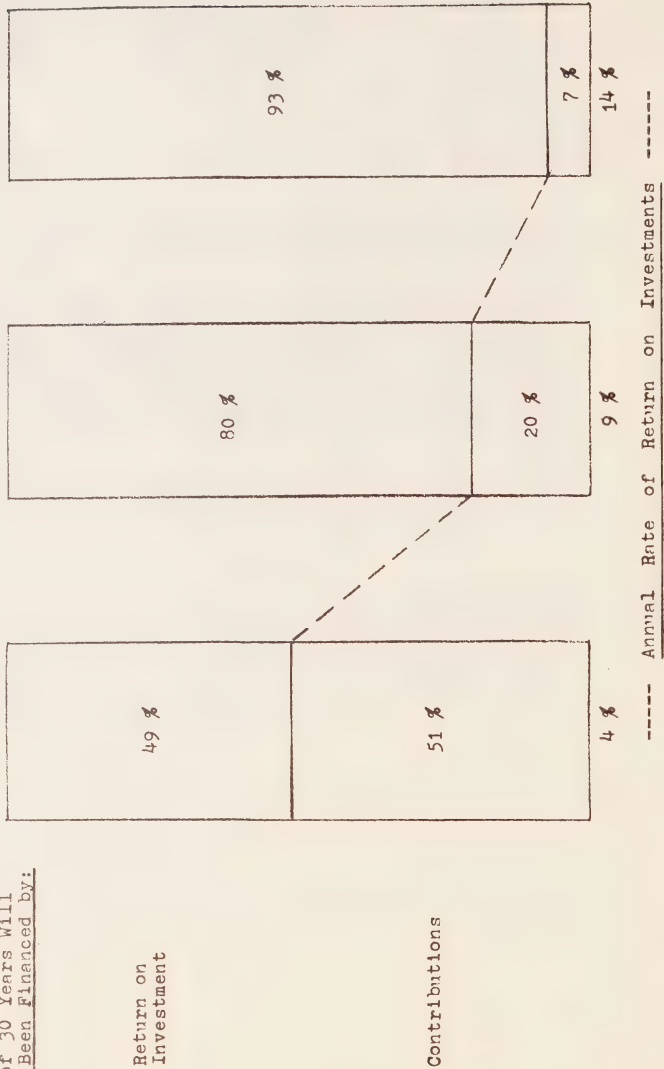
February 23, 1970.

APPENDIX A

HOW HIGHER INVESTMENT RETURNS AID IN FINANCING BENEFITS

(Assuming Equal Annual Contributions
Over a 30 Year Period)

Benefit Reserve at the
End of 30 Years Will
Have Been Financed by:



Note: These figures have been calculated by sources believed to be reliable but not guaranteed by us.

Appendix B

Trend to Equity Investments in State Pension
Funds in the United States

<u>State</u>	<u>Fund Size (\$ Billion)</u>	<u>Percent in Equities</u>	<u>Trend to Equities</u>
California	5.0	7%	\$3.5 billion public employees fund is 10% in equities expected to rise to 25% in 3 years. \$1.5 billion teachers fund is not permitted to buy equities.
Michigan	1.0	12-13%	25% limit expected to be reached in 2 - 2½ years.
New York	3.6	10.4%	30% limit expected to be reached in 3 - 5 years.
Arizona	.3	14.5%	Limit recently raised from 10% to 40% but no time-table
New Hampshire	.1	50%	Expected ultimately to reach 60%.
Texas	.26	18%	75% at trustee's discretion. No time-table.
Minnesota	.7	37%	Limit of 50% but no time-table.
New Jersey	1.8	6-7%	Limit of 10% to be reached by end of 1970.
Massachusetts	.46	4%	Limit of 15%, exclusively in bank and insurance stocks, but no time-table.
Vermont	.8	9%	35% in equities in 2 - 3 years.
Oregon	.45	5%	10% by mid 1970.

Source: The Institutional Investor - February, 1970

APPENDIX C

PERCENTAGE CHANGES IN STOCK PRICE INDICES PUBLISHED BY
THE TORONTO STOCK EXCHANGE
FOR THE PERIOD 1956* TO DECEMBER 31, 1969

* Average Index Value for all of 1956
 (Note: 1956 was the base year for the
 Toronto Stock Exchange industrial sub
 indices)

<u>Toronto Stock Exchange Index</u>	Percentage Change <u>1956 to Dec. 31/69</u>	Weight of Industry Sub-group in TSE Industrial Index <u>at Dec. 31, 1969.</u>
Merchandising	+241.4%	5.21%
Beverage	235.4	8.01
Food Processing	194.7	1.50
Bank	127.3	10.14
1) Western Oil	98.6	-
Pipeline	98.5	4.79
 Toronto Stock Exchange Industrials	 86.4	
 Industrial Mine	 77.7	 25.93
Trust & Loan	73.4	2.46
Steel	57.3	3.75
General Manufacturing	49.7	1.19
1) Gold	47.5	-
Utility	44.3	9.24
Oil Refining	32.5	4.14
Paper & Forest Products	24.4	5.92
Chemical	21.4	0.62
1) Base Metal	15.9	-
Construction & Material	-21.0	0.49
 Miscellaneous Industrials - not an official index of the T.S.E.		 14.45
Real Estate - A new index, commenced October 15, 1968		.58
Communications - A new index, commenced January, 1965		<u>1.58</u>
TOTAL OF INDUSTRIAL SUB-GROUP WEIGHTS		100.00%

- 1) Western Oil, Gold, and Base Metal indices are not components of the TSE Industrial index, but are included in this table in order to provide complete coverage.

Sources: The Toronto Stock Exchange Indices, Fourth Edition, Feb. 1, 1968
Toronto Stock Exchange Review, December, 1969.

Note: These figures have been calculated by sources believed to be reliable but not guaranteed by us.

PERCENTAGE CHANGES IN 106 STANDARD & POOR'S STOCK PRICE INDICES
FOR THE PERIOD 1956 TO DECEMBER 31, 1962

APPENDIX D

Average Index Value for all of 1956.

(Note: 1956 was the base year for the Toronto Stock Exchange Industrial Sub-Indices.)

Standard & Poor's Index	Percentage Change 1956 to Dec. 31/69	Standard & Poor's Index	Percentage Change 1956 to Dec. 31/69	Standard & Poor's Index	Percentage Change 1956 to Dec. 31/69		
Office & Business Equipment	+1218.0%	Telephone - ex AT&T	+169.5%	Sugar Composite	+89.3%	Natural Gas Dis-tributors	+45.4
Cosmetics (1957 base)	847.5	Motion Pictures	168.4	Life Insurance	87.7	Oil - Integrated	43.9
Electronics	841.5	Small Loan Co's	168.0	Containers - Metal	86.9	Beers & Cokes	36.4
Drugs	624.9	Canned Foods	167.0	Containers - Glass		Building Material	
Soft Drinks	616.0	Textile Products	159.4	Toronto Stock Ex-Change Industrials	86.4	Composite	35.2
Office & Business Eqt. - ex IBM	491.5	Property & Liability Insurance	158.2	Tire & Rubber	83.4	Roofing & Wallboard	35.0
Vending Machines	444.3	Consumer Goods	150.8	Finance Co's.	83.2	Machinery - Industrial	33.3
Radio-TV Manufacturers	370.5	Sugar-Beet Refiners	148.8	Confectionery	82.6	Machine Tools	30.3
Radio-TV Broadcasters	363.7	Vegetable Oil Ref.	140.9	Electric Utilities	77.5	Oil - Crude Producers	28.1
Air-Conditioning	305.2	N.Y. City Banks	125.7	Auto Parts & Accessories	75.1	Copper	24.2
Packaged Foods	301.6	Machinery & Services - Oil Wells	124.6	Gold Mining	75.1	Paper	17.7
Publishing	291.3	Biscuit Bakers	122.1	55 Utility Companies	73.9	20 Railroads	10.4
Low Priced Common Stocks	277.7	Metals - Miscel.	120.5	Telephone	72.9	Shipping	2.6
Soaps	277.2	Meat Packing	118.0	Machinery - Agricultural	71.4	Chemicals - ex DuPont	-12.0
Retail - Mail Order & General	274.2	Corn Refiners	117.2	Railroad Equipment	69.9	Chemicals	-14.1
Variety Stores	264.9	Auto Trucks & Parts	115.1	Electrical & Electronic-Major Co's.	69.7	Steel - ex U.S. Steel	-16.1
Electrical Equipment	251.6	Machinery Composite	115.1	Heating & Plumbing	69.3	Aerospace	-16.3
Textile - Apparel	246.4	Capital Goods	108.4	Investment Companies (Closed End)	66.2	Steel	-25.7
Truckers	235.4	Dairy Products	108.0	Sulphur	64.8	Aluminum	-35.2
Retail - Discount (1957 base)	230.1	Metal Fabricating	107.9	Dow-Jones Industrial Average	62.8%	Cement	-30.1
Retail - Dept. Stores	216.0	Shoes					
Coal - Bituminous	205.8	S&P 425 Industrials	103.8				
Home Furnishing	204.9	Banks Outside N.Y. City	102.9				
Elec. Household Appliances	195.7	Machinery - Steam Generating	98.6				
Retail Composite	190.9	S&P 500 Composite Index	97.5				
Cigar Manufacturers	187.4	Savings & Loan Ass'ns. (1959 base)	96.9				
High Grade Common	186.5	Air Transport	96.1				
Distillers	185.5						
Cigarette Manufacturers	179.5						
Machinery - Const. & Equip.	173.3						
Metal - Handling	172.6						
Textile - Synthetic Fibres	170.3						
Food Composite							

(1) Standard & Poor's Trade and Securities Statistics, Security Price Index Record, 1968 ed.

(2) The Outlook, published by Standard & Poor's Corporation, January 12, 1970.

Note: These figures have been listed by sources believed to be reliable but not guaranteed by Standard & Poor's.

Sources
(1) Standard & Poor's Trade and Securities Statistics, Security Price Index Record, 1968 edition.

(2) The Outlook, published by Standard & Poor's Corporation, January 12, 1970.

Note: These figures have been calculated by sources believed to be reliable but not guaranteed by us.

APPENDIX E

1969 DOLLAR VALUE OF TRADING - HIGH EARNINGS
GROWTH RATE CANADIAN COMMON STOCKS

	5-Year Growth Rate, Earnings Per Share 1963-1968	1969 Dollar Value of Trading (\$ Million)
Hiram Walker-G&W	10.1%	77.6
Electrohome	10.3	10.5
Scott Paper	10.4	1.5
R. L. Crain	10.4	4.5
Blue Bonnets Raceway	10.4	2.9
Guaranty Trust Co. of Canada	10.5	6.6
Alminex	10.6	18.3
Distillers-Seagrams	10.8	51.4
Simpsons-Sears "A"	11.2	3.2
Southam Press	11.7	12.7
National Trust	11.7	2.5
North Canadian Oils	11.9	4.2
Ocean Cement	11.9	1.6
Sherritt Gordon Mines	11.9	101.5
Crush International	12.0	18.8
Murphy Oil	12.1	1.4
Pacific Petroleum	12.1	434.6
Hudson's Bay Oil and Gas	12.2	19.5
Central-Del Rio Oils	12.3	20.9
Victoria & Grey Trust	12.4	2.1
Opemiska Copper Mines (Que.)	12.4	15.8
Alcan Aluminium	12.7	264.3
Auto Electric Service	13.0	4.3
Selkirk Holdings "A"	13.0	1.4
Canron	13.2	7.8
Moore	13.4	83.7
Union Gas Co. of Canada	13.4	67.6
Versatile Manufacturing "A"	13.5	35.6
Consumers' Gas	13.5	48.5
Asbestos Corp.	13.9	21.1
G. Tamblin	14.1	0.4
Argus "C" Preferred	14.2	7.7
Texaco Canada	14.3	16.5
Kelly, Douglas & Co. "A"	14.5	1.6
Northern and Central Gas	14.5	42.8

	5-Year Growth Rate, Earnings Per Share 1963-1968	1969 Dollar Value of Trading (\$ Million)
Shaw Pipe Industries	14.5	3.2
FPE-Pioneer "A"	14.6	1.8
Horne & Pitfield Foods	14.8	2.5
International Utilities	15.0	84.0
Noranda Mines	15.1	76.6
Royal Trust	15.1	10.3
Consumers Glass	15.5	1.9
Husky Oil Canada	16.0	90.0
Greyhound Lines of Canada	16.1	4.4
Famous Players Canadian	16.4	19.8
United Canso Oil & Gas	16.4	5.1
Atco Industries	16.8	12.4
Revelstoke Building Materials	16.8	2.4
Unas Investments	17.3	2.1
Toronto-Dominion Bank	★	26.7
Banque Canadienne Nationale	★	8.0
Banque Provinciale du Canada	★	3.8
Bank of Montreal	★	80.6
Canadian Imperial Bank of Commerce	★	67.1
Royal Bank of Canada	★	64.7
Standard Broadcasting	17.9	6.4
John Labatt	18.5	22.8
Dome Petroleum	18.8	169.8
Canadian Homestead Oils	18.8	6.4
Canada Bread (Corporate Foods Ltd.)	21.4	2.6
Couvrette & Provost	21.5	4.8
BACM Industries	21.8	19.6
Canadian Tire "A"	21.9	20.5
Thomson Newspapers	22.5	10.2
Maclean-Hunter	23.1	7.5
Bank of Nova Scotia	★	32.7
Quebec Natural Gas (Gaz Metropolitain)	23.8	3.6
Union Oil Co. of Canada	24.0	5.0
Metropolitan Trust	24.2	OTC
Universal Sections	24.4	3.6
Zeller's	25.4	15.0
Ford Motor Co. of Canada	25.4	33.5

Standing Senate Committee

	5-Year Growth Rate, Earnings Per Share 1963-1968	1969 Dollar Value of Trading (\$ Million)
Placer Development	25.6	19.6
Cunningham Drug Stores	26.7	0.6
Canadian British Aluminium "A"	26.8	4.8
Block Bros. Industries	27.3	25.0
French Petroleum Co. of Canada	27.3	30.6
Great Northern Capital	27.6	8.2
Acklands	27.8	7.0
Koffler Stores	29.3	10.4
Triad Oil	29.4	19.2
Jefferson Lake Petrochemicals of Canada	30.0	27.0
Oshawa Wholesale	30.1	51.5
White Pass & Yukon	32.4	7.5
Y & R Properties	32.5	0.7
Inland Natural Gas	32.7	9.7
Metropolitan Stores of Canada	32.9	3.4
Livingston Industries	33.2	1.5
Granby Mining	35.0	0.02
Control Foods	36.5	0.3
Rothmans of Pall Mall Canada	38.0	12.1
D. H. Howden	39.8	0.2
Brascan Ltd.	40.0	134.2
Numac Oil & Gas	41.7	16.3
Banff Oil	44.7	100.3
Harvey's Foods	50.8	13.5
Becker Milk Co.	59.7	2.6
Sifton Properties	59.7	0.7
Versafood Services	64.0	7.7
Cadillac Development	65.8	4.0
Leigh Instruments	79.3	19.8
Cummings Properties	83.5	2.8
Canadian Equity & Development	83.9	3.3
Richard Costain (Canada)	86.0	1.3
Pine Point Mines	114.5	11.7
Consumers Distributing	214.5	10.5

Sources and Method of Calculation

5-Year Earnings Growth Rates - The Blue Book of Canadian Common Stocks, Burns Bros. and Denton Limited, October 1969.

Trading Volume Figures -

Toronto - The Toronto Stock Exchange Review, December 1969.

Montreal and Canadian - The Monthly Review, published by the Montreal and Canadian Stock Exchange, December 1969.

New York - The Toronto Stock Exchange Review, October, November, December, 1969.

The dollar value of 1969 trading volume was obtained by multiplying the number of shares traded in each issue by the average of the high and low price of the stock in 1969.

*Comparable figures for all the Canadian Chartered Banks are not available. However, they are believed to have exceeded 10% per annum.

OTC - Over the Counter

Note: These figures have been calculated by sources believed to be reliable but not guaranteed by us.

APPENDIX F

Performance of Canadian and U.S. Industry Stock Price
Indices in Periods when the Toronto Stock Exchange
Industrial Index Declined

			<u>Percentage Change in Industry Indices</u>			
			(A)		(B)	
<u>Period of Decline in Toronto Stock Exchange Industrial Index</u>			<u>Standard & Poor's Subgroup</u>		<u>TSE subgroups which performed better than the worst S & P Group listed under (A)</u>	
<u>Peak</u>	<u>Trough</u>	<u>% Decline</u>				
July 1956	Dec. 1957	-26.2%	Drugs	+21.8%	Merchandising	- 3.5%
			Office Equipment	+12.7%		
			Soaps	+ 4.6%		
			Electrical & Electronic	- 4.7%		
			Tire & Rubber	- 5.9%		
July 1959	July 1960	-15.6%	Soaps	+35.8%	None	
			Soft Drinks	+26.4%		
			Office Equipment	+13.0%		
			Cosmetics	+12.5%		
			Variety Stores	+ 9.3%		
			Electrical & Electronic	+ 4.8%		
			Drugs	+ 2.2%		
Dec. 1961	June 1962	-18.8%	Oil Integrated International	- 6.1%	Gold	+ 7.4%
			Radio Broadcast- ers	- 7.2%	Paper & Forest Pdts.	- 6.0%
			Home Furnishing	-11.5%		
Apr. 1965	Sept. 1966	-19.0%	Air Transport	+31.6%	Gold	+ 6.5%
			Cosmetics	+15.8%	Base Metal	+ 4.5%
			Office Equipment	+ 6.1%		
			Drugs	+ 1.3%		
			Air Conditioning	+ 0.8%		
			Electrical & Electronic	- 4.6%		
			Tire & Rubber	- 5.0%		
July 1967	Mar. 1968	-13.5%	Office Equipment	+11.6%	Gold	+18.1%
			Cosmetics	+10.4%	Merchandising	+11.1%
			Tire & Rubber	+ 4.8%		
			Soft Drinks	+ 3.0%		
			Air Conditioning	+ 1.3%		
			Soaps	+ 1.0%		
			Variety Stores	+ 0.7%		

Note: These figures have been calculated by sources believed to be reliable but not guaranteed by us.

APPENDIX "F"

NAME: BANK OF MONTREAL PENSION FUND SOCIETY

SUBJECT: Pension Plans - limitation on foreign investment

Analysis of Appendix "E" by Senior Advisor.

This brief is submitted by the Pension Fund Society of the Bank of Montreal, an organization which took over in 1884 an original fund begun in 1861. The fund, a contributory one is confined to male managerial and clerical employees. Other employees being granted retirement allowances directly by the Bank. In 1967 this latter system was formalized as the Second Pension Fund Society of the Bank of Montreal.

Membership in the first society is about 5,000 and in the second society about 13,000.

While comments of the brief refer specifically to the first society they also have general application to the second society.

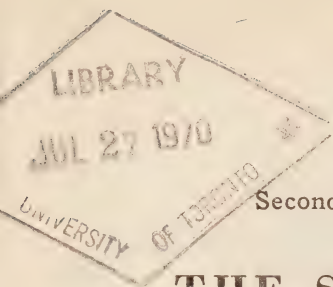
It is stated in the brief that until the mid 50's the pension fund investments were mainly fixed income securities, thereafter investments were made in common stocks. At December 31, 1969 approximated 35% (of the book value) of the first society's and 47% (of the market value) of the second society's investments were in common shares, of which approximately 50% in each case were United States securities.

The comments in the brief are limited to the White Paper proposal that pension plans cannot invest more than 10% of their assets in foreign securities or other foreign investments.

Standing Senate Committee

The attention of the Committee is drawn to the following remarks:

1. "In our opinion, the objectives of Canadian pension fund administration are to maximize the level of pension benefits and minimize the cost of these benefits to Canadians, with due consideration being given to other national goals in seeking to achieve these objectives."
(Page 2 of the brief)
2. "Today, considerable emphasis is put on professional investment guidance in recognition of the fact that a 1% improvement in investment return can produce over thirty years a 20% reduction in costs, or a 25% increase in benefits. To the extent a reduction in costs is achieved, a larger corporate and/or personal tax base results."
(Page 4 of the brief)
3. "As a consequence of the recognition that even small improvements in yield can, over a long period of time, have a substantial impact on the operations of the pension fund, there has been in many instances a marked shift away from fixed income securities towards equities, where higher total yields, comprising dividends and realized and unrealized capital gains, have been available."
(Page 5 of the brief)



Government
Publications

Second Session—Twenty-eighth Parliament

1969-70

THE SENATE OF CANADA

PROCEEDINGS

OF THE

STANDING SENATE COMMITTEE

ON

BANKING, TRADE AND COMMERCE

The Honourable LAZARUS PHILLIPS, *Acting Chairman*

No. 32

THURSDAY, JUNE 11th, 1970

*Twenty-Sixth Proceedings on the Government White Paper,
entitled:*

"PROPOSALS FOR TAX REFORM"

WITNESSES:

(For list of witnesses see Minutes of Proceedings—Page 32 : 5)

APPENDICES:

"A"—Brief from Mr. G. Arnold Hart, Chairman and Chief Executive Officer, Bank of Montreal.

"B"—Brief from The Canadian Institute of Chartered Accountants.

"C"—Brief from the Vancouver Board of Trade.

THE STANDING SENATE COMMITTEE ON
BANKING, TRADE AND COMMERCE

The Honourable Salter A. Hayden, *Chairman*

The Honourable Senators:

Aird	Croll	Isnor
Aseltine	Desruisseaux	Kinley
Beaubien	Everett	Lang
Benidickson	Gélinas	Macnaughton
Blois	Giguère	Molson
Burchill	Grosart	Phillips (<i>Rigaud</i>)
Carter	Haig	Walker
Choquette	Hayden	Welch
Connolly (<i>Ottawa West</i>)	Hays	White
Cook	Hollett	Willis—(30)

Ex officio members: Flynn and Martin
(Quorum 7)

ORDERS OF REFERENCE

Extract from the Minutes of the Proceedings of the Senate, November 19, 1969:

“With leave of the Senate,

The Honourable Senator Martin, P.C., moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on Banking, Trade and Commerce be authorized to examine and report upon the White Paper intitled: “Proposals for Tax Reform”, prepared by the Minister of Finance, and tabled in the Senate on Tuesday, 18th November, 1969.

After debate, and—

The question being put on the motion, it was—
Resolved in the affirmative.”

Extract from the Minutes of the Proceedings of the Senate, December 19, 1969:

“With leave of the Senate,

The Honourable Senator Phillips (*Rigaud*), moved, seconded by the Honourable Senator Robichaud, P.C.:

That the Standing Senate Committee on Banking, Trade and Commerce be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—

The question being put on the motion, it was—
Resolved in the affirmative.”

Extract from the Minutes of the Proceedings of the Senate, February 18, 1970:

“With leave of the Senate,

The Honourable Senator McDonald moved, seconded by the Honourable Senator Hayden:

That the Standing Senate Committee on Banking, Trade and Commerce have power to sit during adjournments of the Senate.

After debate, and—

The question being put on the motion, it was—
Resolved in the affirmative.”

ROBERT FORTIER,
Clerk of the Senate.

MINUTES OF PROCEEDINGS

THURSDAY, June 11th, 1970.
(51)

MORNING SITTING

Pursuant to adjournment and notice the Standing Senate Committee on Banking, Trade and Commerce met this day at 9:00 a.m. to further consider:

The Government White Paper entitled: "Proposals for Tax Reform".

Present: The Honourable Senators Aseltine, Beaubien, Benidickson, Burchill, Carter, Cook, Desruisseaux, Everett, Haig, Hays, Hollett, Isnor, Molson, Phillips (*Rigaud*) and Welch—(15).

* The Honourable Senator Phillips (*Rigaud*) *Acting Chairman* in the Chair.

Present, but not of the Committee: The Honourable Senator Smith—(1).

In attendance: Roland B. Breton, Executive Secretary.

WITNESSES:

Bank of Montreal

Mr. G. Arnold Hart, Chairman and Chief Executive Officer;

Mr. N. E. Currie, Vice-President and Economic Advisor.

The Canadian Institute of Chartered Accountants

Mr. R. D. Brown, Toronto;

Mr. W. E. Goodlet, Toronto;

Mr. D. R. Huggett, Montreal;

Mr. W. K. McIntyre, Secretary, (CICA), Toronto;

Mr. C. McLaughlin, Montreal.

At 12:00 Noon the Committee adjourned.

AFTERNOON SITTING

2:15 p.m.
(52)

At 2:15 p.m. the Committee *resumed*.

Present: The Honourable Senators Aird, Aseltine, Beaubien, Benidickson, Burchill, Carter, Cook, Desruisseaux, Everett, Haig, Hays, Hollett, Isnor, Molson, Phillips (*Rigaud*), Welch and Willis—(17).

* The Honourable Senator Phillips (*Rigaud*) *Acting Chairman* in the Chair.
In attendance: Roland B. Breton, Executive Secretary.

WITNESSES:

Continuing with The Canadian Institute of Chartered Accountants.

Vancouver Board of Trade

Mr. E. W. Disher, President;

Mr. D. H. Parkinson, Chairman, Taxation Committee;

Mr. P. Walton, Vice-President, Taxation Committee;

Prof. A. R. Ilersic, Economist—Tax Consultant.

Ordered: That the documents submitted at the meeting today be printed as appendices to these proceedings, as follows:

A—Brief from Mr. G. Arnold Hart, Chairman and Chief Executive Officer, Bank of Montreal.

B—Brief from The Canadian Institute of Chartered Accountants.

C—Brief from the Vancouver Board of Trade.

At 4:20 p.m. the Committee adjourned to the call of the Chairman.

ATTEST:

Frank A. Jackson,
Clerk of the Committee.

THE STANDING SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE EVIDENCE

Ottawa, Thursday, June 11, 1970

The Standing Senate Committee on Banking, Trade and Commerce, met this day at 9 a.m. to give further consideration to the White Paper entitled "Proposals for Tax Reform".

Hon. Lazarus Phillips (*Acting Chairman*) in the Chair.

The Acting Chairman: Honourable senators, our first brief this morning is being presented by the Bank of Montreal. I have the pleasure of having to my immediate right, Mr. G. A. Hart, Chairman of the Board and Chief Executive Officer. If I wished to say that this bank is Canada's greatest commercial bank I would be in trouble. Next to Mr. Hart is Mr. N. E. Currie, Vice-President and Economic Adviser for the bank.

Mr. Hart, we welcome you and Mr. Currie. The general procedure is to ask you to be good enough to make a summary of your representations and views. Thereafter the practice is for honourable senators to engage in an interchange of questions and answers with the view of the elicitation of the points of your brief.

Mr. G. A. Hart (*Chairman of The Board and Chief Executive Officer, Bank of Montreal*): Thank you, sir. Mr. Chairman and honourable senators, my opening remarks will be brief. I wish first to express my appreciation for your invitation to appear before you, to comment on the written brief on the Government's White Paper on Tax Reform which I submitted to you a couple of months ago.

Since that time I have been following with interest reports of the proceedings in this committee, and the debate elsewhere, and as a result I am more than ever convinced of the wisdom of the Government's decision to facilitate public discussion of their proposals by putting them forward in a White Paper rather than in the form of draft legislation. I am confident that the end result of this proc-

ess will be much better tax legislation than would otherwise have been achieved. The objective, of course, has to be the enactment of the best possible tax legislation for the realization of Canada's great potential for economic growth, since we would clearly be misleading ourselves if we thought that other worthwhile social and economic objectives are realizable without genuine economic growth in real terms.

It is to this question of the relationship between taxes and economic growth that my submission to you is primarily directed. The main points I have covered are indicated in the summary that is already in your hands, so there is perhaps no need to repeat them at this time.

I simply want to say, by way of introduction, that my brief represents my own views as a Canadian concerned for the healthy economic and social development of our country. While my views are necessarily influenced by my own working experience, through which I have acquired some degree of familiarity with the considerations that influence decisions in the economic area, the comments set out in my submission are not intended to represent the views of the bank I have the honour to serve. Indeed, my brief does not deal specifically with tax proposals that may be considered to be of direct relevance to the operations of banks.

One other thing may be worth mentioning. As I indicated in my written submission, I am not a tax expert and if the discussion today leads us into the intricacies of tax law I may have to suggest that these are technical details for the experts to look into. With this caveat I shall be pleased to attempt to answer any questions you may direct towards me, Mr. Chairman.

The Acting Chairman: Mr. Hart, would you like to table the summary of your brief. We will regard that as having been read so that it will form part of this morning's transcript as

distinguished from the brief proper. Honourable senators in due course may wish to study the material which has come before us. Are there any questions, honourable senators?

Senator Molson: Before we go further, I should say that as a Director and Vice-President of the Bank of Montreal, I think it is quite proper for me to be here and participate in these proceedings since Mr. Hart is making his submission from his own personal point of view rather than on behalf of the bank.

The Acting Chairman: I would think so, Senator Molson and that also applies to Senator Cook.

Mr. Hart: May I say, sir, that you are probably aware that the Canadian Bankers' Association is preparing a brief for submission so presumably they will speak on behalf of the bank.

The Acting Chairman: Mr. Hart, while the senators are considering their questions, may I say that there has been, if not a unanimous expression of opinion pretty close to that, that the thrust of the White Paper would be inflationary on a continuous basis in its effects, because of the diversion of increased sums referred to in the White Paper, based upon the computation with which you are familiar of about \$600 million at the end of the fifth year, and from other sources, exceeding \$1,200,000,000. Leaving aside the contentiousness of the figures as such, would you like to express an opinion on this basic point, as to whether you consider the overall thrust of the White Paper in its approach to taxation, etc., as being inflationary?

Mr. Hart: That certainly is my opinion, Mr. Chairman, that it does have a very strong inflationary impact on the economy of the country. There are many aspects of this. I think the heavy burden of tax which would be imposed if the reforms proposed in the White Paper were adopted, in itself has an inflationary aspect because, if people are going to have to pay higher taxes, wage earners are going to want more money, salary earners are going to want more salary, everybody gets into the act, if I might put it that way and there is a tremendous demand on the economy for looking after oneself and not being too concerned about the other fellow. As long as you can protect yourself, fine; if you can protect yourself by demanding higher wages and salaries as the case may be. This is

the inflationary impact, I submit. Secondly, the White Paper itself implies that savings will be discouraged and spending will be encouraged. This obviously has a very strong impact on inflation in this country, because the dollars that are saved and are put to work to improve the economy of the country can be used in such a way that one always hopes to reduce any inflationary impact, but on the other hand if people are going to be encouraged to spend and put greater pressure then on the demand for goods and services this again is going to increase the cost and is bound to do so.

The Acting Chairman: Is it your experience that when Government gets increased revenue resulting from diversion of the GNP, that the increased moneys are used by Government for amortization of debt rather than for expansion of the administrative services, social services and so on?

Mr. Hart: I am afraid it is not the case that they do use such sources of revenue for the reduction of the public debt. Unfortunately, they seem to get into other areas such as social services. I am not condemning the use of the funds for social services, if properly approved, and on a priority basis, in the Government's wisdom, for which purposes the funds should be used. But I think there is always a tendency that the more money you have the more money you are going to spend. You are not going to apply it in the reduction of public debt. This has been the case in the past. There have been times when the debt has been reduced by very small amounts but it has been quickly brought up to the level, or increased again. That has been my experience.

The Acting Chairman: Thank you. Senator Everett.

Senator Everett: Mr. Hart, on page 31 of your brief, you say:

Furthermore, within the smaller total, the White Paper proposals are designed to provide "a powerful incentive for equity investment by Canadians in Canadian corporations". This may indeed be a desirable result but it should be recognized that, other things being equal, this must reduce the amount of domestic savings available for investment in bonds and other fixed interest securities and mortgages.

Then you go on, sir, to say, on page 33, from the last sentence of the first paragraph:

The total thrust of the White Paper proposals would seem to suggest, therefore, that relatively higher interest rates in Canada will be required to attract the necessary in-flow, and it would not seem to be feasible, given a particular growth objective for Canada, to adopt monetary and fiscal policies designed to offset the upward pressure on interest rates that will flow from the White Paper proposals themselves.

In our Finance Committee, Mr. Hart, we have been very interested in the long-term effect of very high interest rates. I distinguish between the long-term effect and the short-term effect. If your prediction comes true, that the White Paper is going to create a situation in which, due to the lack of debt money, Canada is going to have inordinately high interest rates, apparently over a long period, could you as a professional banker of considerable experience, tell us what you think will happen to the Canadian economy over that number of years as a result of this exercise?

Mr. Hart: Mr. Chairman and senator, this of course is a very searching question, as to what will happen to the Canadian economy. I will do my best to answer.

First of all, I think high interest rates are not good for any economy. I have always held that opinion that the sooner we can get the general level of interest rates down, the better for the economy of the country as a whole. First of all, the impact of high interest rates, what does it do with respect to Government expenditures? Governments cannot sell equity to the public; they can only borrow by way of debt, or creating debt. Therefore, if the high interest rates continue and get even higher, then the cost of servicing public debt becomes that much higher and that falls eventually on the shoulders of the taxpayers, as the only source from which they can get the funds. So this has a very very substantial impact on the economy of the country.

Because of this, it may mean that the Government itself—and I am not talking just about federal, but about other government levels also—will have to borrow more and more money. So there is a heavier impact on the bond market as a result, or on fixed interest securities markets. And because of that, others who have to borrow in that market—

be they corporations or provincial governments or whatever they may be—have to pay higher rates of interest. So the thing feeds on itself.

I can only foresee that, if the proposals in the White Paper are adopted as put forward, it is going to have a rather serious impact on the market for fixed interest securities, because of this impact on the interest rate, which I am sure would come about because there will be a greater demand on that market for funds. Then you get into the field of mortgages. Goodness knows, there seems to be a shortage of mortgage money now in Canada and the rates of interest are very high. This, then, has an impact on house building and on the home owner. It eventually permeates the whole economy.

Senator Molson: Inflationary in effect.

Mr. Hart: And inflationary in effect.

Senator Everett: Yes. I assume that in order to keep these interest rates under any reasonable ceiling the central bank would have to add constantly to the money supply?

Mr. Hart: That is right.

Senator Everett: And I suppose that, in doing that, as Senator Molson has indicated, it would be (a) inflationary and (b) it would seriously affect the value of the Canadian currency as a foreign exchange currency. What would it do, in your judgment, Mr. Hart, to the growth of business enterprise?

Mr. Hart: In that type of an environment, of course, any enterprise is bound to grow because of the inflationary impact. Inflation itself is growth of a sort, but very undesirable growth. In the final analysis, I think nobody gains. I do not think private enterprise would gain. Certainly the individual does not gain, the Government does not gain. We all suffer as a result of inflation. This is one further impact on the inflationary spiral that you mention.

Senator Everett: I think you make the point in your brief that the resultant high interest rates and inflation would fall most heavily on those least able to pay the cost.

Mr. Hart: This unfortunately has always been the case. Take the increase in the consumer price index, it falls on those people who can ill afford to pay the higher cost of the essentials of life that they need.

Senator Burchill: Mr. Chairman, before we go on to another subject, may I ask a question on the matter of high interest rates. We were discussing high interest rates just from the standpoint of Canada, but are not high interest rates an international condition, worldwide? The White Paper deals with Canada, but what about conditions outside of Canada? Will they not have a bearing on the interest rates in Canada? We have always understood that there are Canadian banks—although on the street today, on account of the lifting of the ceiling, we hear the man on the street blame the banks for their complicity in the high interest rates. Senator Molson has told us more than once that the Canadian banks had nothing to do with it, that it is an international situation. Is that not going to have a bearing on the future of high interest rates—the international situation?

Mr. Hart: Yes, senator, I think we must have regard to the international situation. Unfortunately in the western world, which is the one we know best, inflation has been rampant in most countries. They are all suffering the same as we are. The point I make is that if the proposals in the White Paper are adopted, we are adding a further burden to this country which is going to put us, perhaps, off base in relation to the other countries who are struggling with inflation, too. This is an international disease, not just a national disease.

Senator Burchill: Yes.

Mr. Hart: I accept your point, but somehow, somewhere, some day, something has to be done to stop this inflationary spiral, because we all suffer. The international bankers know this, the international corporations, everybody, the other governments know it. It is a very very difficult problem. I just do not want to see Canada add to its own burden and make it worse.

Senator Molson: Mr. Chairman, I would like to ask Mr. Hart to go to page 6, subparagraph (c), where he says that he wholeheartedly supports the move towards integration of corporate and personal income tax. Then, on page 24, Mr. Hart, you say that while you are in favour of the principle you do not think that the method suggested is very adequate as mechanism. Have you any other views on this, Mr. Hart, whether it is better to go closer to what the minister is trying to do here or whether it is better to stay where we are now?

Mr. Hart: If I may say, Senator Molson, the word "integration" of course comes from the White Paper. What I am arguing for really is more a matter of co-ordination between corporate tax and personal tax. While I myself have stated that I am wholeheartedly in favour of dividends being tax deductible as far as the corporation is concerned and then taxable in the hands of the recipient, I realize it raises certain problems which would have to be considered very carefully. But I think in this whole matter, what has been proposed in the White Paper seems to be unduly cumbersome. I think if we could simplify it more and get the revenue we are getting now—I am certainly not in favour of increasing the revenue to the extent that the Chairman has mentioned, and in another place an even higher estimate has been mentioned. This is wrong in principle. I think the whole body of the White Paper should be based on simplifying the taxing process and making it bear on those who are most able to support increased taxes, but not for the purpose for making a very substantial increase in revenue such as has been proposed.

Senator Molson: Is it fair to say that the principle of integration as it applies to taxing revenues once rather than having double taxation is very much in your mind?

Mr. Hart: Yes. This is what I favour, senator, yes.

Senator Molson: If it can be achieved?

Mr. Hart: If it can be achieved. Because you are taxing the same dollar twice, and I do not think in principle that is quite fair.

Senator Everett: Both verbally and in your submission, Mr. Hart, you referred to the dividend deductible mechanism, where dividends would be deductible expenses for the corporation and would be fully taxable in the hands of the shareholders. Could you give us more detail on the dividend deductible mechanism?

Mr. Hart: Well, I think it is very simple to make the statement, but it may be somewhat more difficult for the taxing authorities to work it out. I acknowledge that and I appreciate it. But it is simply the case that the corporation would be able for tax purposes to deduct the dividends disbursed to the shareholders, and the impact of the tax then would fall on the shareholders or the recipients of the dividends at whatever tax level they might be on the tax scale.

Senator Beaubien: But that is a reversal of the White Paper, Mr. Hart.

Mr. Hart: Well, it goes farther than the White Paper. The White Paper talks about integration and grossing up and all this sort of thing, and sort of go half way. I think it would be better to go the whole way, senator.

Senator Beaubien: In the White Paper, the corporation pays 50 per cent tax.

Mr. Hart: That is right.

Senator Beaubien: And then the shareholder gets a dividend on which he gets...

Mr. Hart: A gross-up.

Senator Beaubien: An abatement.

Mr. Hart: That is right.

Senator Beaubien: Are you suggesting that the dividends paid out will be tax deductible for the corporation?

Mr. Hart: That is right.

Senator Beaubien: That is a totally opposite approach.

Mr. Hart: Yes, it is in that context, yes. In other words, the dividends would be taxable only in the hands of the recipients and there would not be two taxes.

Senator Beaubien: Mr. Chairman, that is the point that we brought up the other day when we said that if you reduced the corporation tax and left the 20 per cent as it is now, it would work out on a more equitable basis.

The Acting Chairman: I am glad you raised that point, Senator Beaubien, because that is the very point I wanted to put to Mr. Hart. The representations concerning the integration system have been almost unanimous that it is cumbersome and difficult of administration and implementation, and one of the alternatives suggested was that the corporate rate should be reduced to, say, 45 per cent and the tax credit of 20 per cent be retained. What would you think of that as an alternative approach to the one that you have suggested here on page 24?

Mr. Hart: Well, let me say this, Mr. Chairman; I am certainly in favour of any tax deduction. If the method I have suggested cannot be implemented at the present time, then at least, perhaps, we could work towards it. But if there is a possibility of a tax reduc-

tion being made, I would certainly be all in favour of it. You mentioned the 20 per cent. Under my scheme that would have to be dropped, of course. I feel also that you might have to broaden the tax bracket in the centre, the group that is now going to bear the burden of the White Paper—those earning up to, say, \$25,000. If you had to increase the tax a little more there, then it could be only on the basis that you are going to forego this terrible capital gains tax on unrealized capital gains, which I think is deplorable. I do not know of any other country in the western world that has such a tax.

The Acting Chairman: Well, we will come to that a little later.

Mr. Hart: But there would have to be adjustments if this suggestion which I have made were followed. But certainly I would be in favour of any reduction in tax in the interim period.

The Acting Chairman: On your suggestion, Mr. Hart, would there not be pressure from shareholders on corporations who declared, unwisely, dividends because the amount paid would be deductible as an expense?

Mr. Hart: Well, I suppose there might be some of that, Mr. Chairman, but after all, if a company is properly run, they are going to want to preserve as much money as they can for further expansion of the company without having to resort to raising further capital and putting further pressure on the capital market, which we were discussing earlier. There is always the temptation on the part of certain shareholders who want more and more money without giving too much thought to the future of the company of which they are shareholders. I think we have this situation to some extent now, and I do not suggest it would be any worse.

Senator Beaubien: Mr. Hart, the dividends paid by the company would be deductible as an expense?

Mr. Hart: Yes, that is right. But in the corporation. And then it would be taxable, of course, in the hands of the recipients.

Senator Everett: Mr. Hart, would this mean that the maximum corporation rate and the maximum individual rate would have to be the same as they are proposed, or roughly the same as they are proposed in the White Paper?

Mr. Hart: No. As I was suggesting a moment ago, senator, it might be that the 50 per cent rate for personal income tax might have to be a little higher. But it could only be done, I suggest, on the basis that we get away from this capital gains tax on unrealized capital gains and other factors which enter into it to offset the higher tax which might have to be paid. So, the net result to the individual should not be any worse than under the present system.

Senator Everett: But if the individual rate were to go as high as, say, 70 per cent as against a corporate rate of 50 per cent, would you not run into a certain amount of trouble with your shareholders then?

Mr. Hart: Well, I don't know where the 70 per cent comes from, senator. It might not have to be that high. I do not have any calculations to show that.

Senator Everett: Well, I am just dealing with the principle of your system in trying to find out...

Senator Beaubien: Excuse me, Senator Everett, but it would not be 50 per cent if the dividends were tax deductible, because everything that was paid out would be an expense and so the corporation would not be paying anything like 50 per cent.

Senator Everett: No, but the corporation would be paying initially a corporate tax.

Mr. Hart: After payment of dividends, yes. That would be just like after bond interest now which is deductible for tax purposes.

Senator Beaubien: If a corporation made \$5 million, Senator Everett, and it paid out \$3 million to its shareholders, then it would pay 50 per cent on the remainder which would be \$1 million out of \$5 million.

Senator Everett: Nevertheless your effective marginal rate would be 50 per cent.

Senator Beaubien: But it would still be only \$1 million out of \$5 million.

Senator Everett: But it is still an effective marginal rate of 50 per cent, and it strikes me that to make the system workable the top marginal individual rate would have to be closer to 50 per cent which, in effect, is what the White Paper proposes.

Mr. Hart: Well, that is true, but of course we have much higher rates now for personal income tax.

Senator Everett: But we are under another system.

Mr. Hart: Yes, we are under another system, that is quite true. And this may be—if I may put it this way—a sort of a sop to sell the White Paper by reducing that to a maximum of 50 per cent. All I say is that it might have to be a little more than that to introduce the scheme that I have proposed. But other factors enter into it such as capital gains and things like that which have to be modified.

Senator Everett: Yes, you have suggested modifying that, of course.

Mr. Hart: That is right.

Senator Everett: This is a terrible question to ask anybody, but can you tell me the defects of your proposed system.

Mr. Hart: The defects?

Senator Everett: Yes.

Mr. Hart: Well, I suppose any system has defects, but it should not cause any more difficulty in collecting the tax, I would assume. In fact, it should simplify it. The whole process I mention should simplify the matter considerably. If I may turn to my colleague, Mr. Chairman, on this.

Mr. Currie: do you have any thoughts on defects?

Senator Beaubien: I would like to help you out, Mr. Hart, on one point. If dividends were deductible as an expense, companies would be paying out roughly three times as much as they are now on dividends. Therefore, the stocks would go to great heights. It would upset the applecart. Pension funds would buy nothing but common stocks, so you would have a situation where it would be very difficult to sell bonds. In other words, if a company makes \$5 million and pays \$2½ million in corporation tax today, out of the remaining \$2½ million it might pay \$1¼ million in dividends. Under the proposed system if the dividend paid was tax deductible, the corporation, say, would pay out \$3 million in dividends, and only \$1 million of the remaining \$2 million in corporation tax. Therefore, the value of that stock on the market would go extremely high. Pension funds and other non-taxable institutions would be bound to buy common stocks and it would be very difficult, therefore, to sell bonds.

Mr. Hart: Yes, and Lord knows it is difficult enough now. One aspect of this, of course, as I foresee it, is that the corporation would not pay out all its surplus in dividends, by any means. If it is a properly run corporation, it would retain sufficient funds to build up the business. So, to that extent...

Senator Beaubien: But that would be free money it does not get now.

Mr. Hart: I beg your pardon?

Senator Beaubien: According to the way I see it, a company earning \$5 million would retain \$1½ million more than ordinarily it would now in its coffers simply because its taxation would be so reduced.

Senator Everett: Not if it paid it out.

Mr. Hart: Not if it paid it out, but if they retained that then the tendency would be to lean less on the long-term market for borrowing funds. In other words, they are generating funds within the business itself to expand the business.

Senator Benidickson: On this point, Mr. Chairman, which refers to the avoidance of double taxation, Mr. Hart says in the brief, on page 24, that the alternative to what is proposed in the White Paper on abatement, the one that seems to have the widest support is his proposal of a dividend deductible mechanism. I do not think so, Mr. Hart. We have had people who reject the proposal in the White Paper, for the most part, expressing a preference for the retention of the present system of a dividend tax credit. They say the dividend tax credit is not enough to equal the complete abatement that is possible under certain circumstances of the White Paper, but I would not want you to think that we have had a great many representations duplicating the proposal you made, worthy as it may be. It certainly has the merit of simplification. I do not think we can expect you to be a witness thinking along political lines, but to someone looking for defects, it appears to me that your proposal has very serious defects from a psychological and political point of view.

If I were the Minister of Finance and had indicated that I was wanting to encourage investment by Canadians in Canadian stock, I think that I would want the credit respecting those hundreds of thousands of dividends to be obvious to the persons receiving the dividends, and if the form of deduction was simply on the books of the company, as you

propose, then there would not be that impact on the individual Canadians who see, if they have invested in Canadian stocks, that in one form or another, either by dividend tax credit, as we have at the moment, or by the rather complicated proposals of the White Paper, when they prepare their income tax they get credit. Of course, they do not get a credit if it is a non-Canadian company. I think there is a psychological stimulus there to encourage investment in Canadian stocks, which is apparently one of the aims of the White Paper.

Mr. Hart: I accept what you say, senator. I also submit the suggestion I have made should not discourage people from investing in Canadian stocks if they are going to get good dividends. I should think they would be encouraged to do so.

Senator Beaubien: I think the shrewd and sophisticated investor would see that the same benefit results to him under your proposal, but, by and large, so many investors would lose sight of the attempt to avoid double taxation, because he personally still pays an income tax on that dividend and does not fully appreciate that some relief was given to him in the books of the corporation itself.

The Acting Chairman: Before we leave that subject, and following Senator Benidickson, we in this committee have not received, as he indicated, any evidence of wide support for this suggestion which is, of course, intriguing. You can see how it has elicited questions and answers. May I ask you, Mr. Hart, what is behind your statement that there is such wide support? Have we any evidence that we could read into the record for our consideration, or is it just an impression on your part?

Mr. Hart: It is a little more than an impression, Mr. Chairman. I said it seems to have wide support. Perhaps this is semantics. I know that the Canadian Council of the International Chamber of Commerce, for example, have put forward this view, and I saw in the paper just yesterday that the submission to the other committee by the Canadian Chamber of Commerce put forward a similar view. This is two months after I put mine forward, so that there is no collusion, I can assure you. They have not seen my paper. So, that represents some 700 chambers and boards of trade across the country, so there may be fairly wide support for this.

Senator Everett: I think it is a most admirable suggestion but, of course, our function is to find out if it is or is not workable. Could you tell me what would happen to exempt income—that is, income of a corporation on which it does not pay tax? Suppose it is distributed to the shareholder, what would be the mechanism there, under this system?

Mr. Hart: If the corporation is not paying tax now, it would follow through that the shareholder receiving a dividend does not pay tax either.

Senator Benidickson: You get no benefit...

Mr. Hart: You get no benefit from it.

Senator Benidickson: You get no benefit from the depletion or depreciation.

Mr. Hart: That is right.

Senator Beaubien: Could it be charged as an expense, if the dividend is paid out of the fund and is not taxed? Your whole point is putting the dividend as a business expense?

Mr. Hart: That is right, the same as bond or mortgage interest. Dividends would be on the same basis.

Senator Everett: So on dividends paid out of corporation income that was not taxed, there would be no deduction?

Senator Beaubien: You mean, as a business expense?

Senator Everett: As a business expense, the dividend would not be deductible?

Mr. Hart: If they are not paying tax, there would be no necessity.

Senator Everett: Although one can imagine a situation where part of the corporation's income is taxable and part is not.

Mr. Hart: Well, yes. I am afraid, senator, it is getting into technicalities and I am not a tax expert, as I said. It had to be worked out.

Senator Everett: I am not trying to trap you in technicalities.

Mr. Hart: No, I realize that.

Senator Everett: This is the first time we have had a chance to discuss this, interestingly enough, although you say it has widespread support. It is the first time we have had an opportunity, on the record, to discuss this particular mechanism.

The Acting Chairman: That is why I indicated to Mr. Hart that it has excited considerable interest, as you see, in the minds of the senators.

Senator Everett: Just carrying on with that for a moment, you then say that this dividend, which, of course, would not be deductible, would then pass to the shareholder tax-free; he would not pay tax on it.

Mr. Hart: No, he is paying tax. In the hands of the recipient...

Senator Everett: In the hands of the recipient...

Senator Beaubien: ...it is fully taxed.

Senator Everett: Thank you, Senator Beaubien. Let us go through it again. The corporation has exempt income?

Mr. Hart: Yes.

Senator Everett: And it passes it out in the form of a dividend to the shareholders. It does not receive a deduction for that dividend, but that income in the hands of the shareholder is taxable.

Mr. Hart: Yes.

Senator Everett: One of the criticisms that has been levelled against the White Paper is that where there is no creditable tax in the corporation as a result of an exemption that was granted to the corporation then, in effect, the Government is giving to the corporation a tax benefit with one hand, and taking it away from the shareholder with the other hand. Now, you can see in the exercise that we just did that the same problem is arising in your system, and I am wondering if there is any way around that.

Mr. Hart: All I can suggest, senator, is the proposal that is put forward in my brief. If that were followed then everybody would be on the same basis, and it would not matter whether a corporation had income that was free of tax, because that income, or the dividends paid out, will be taxable in the hands of the recipients, the beneficiaries, or the shareholders. That is where the tax...

Senator Everett: ... would be exigible.

Mr. Hart: Yes.

Senator Everett: But you do follow the criticism that is being made, that under the proposals in the White Paper a tax benefit is

given to the shareholder, and then is taken back from the shareholder.

Mr. Hart: Yes, but everybody is on the same basis in the scheme I have put forward. Everybody pays tax within his tax bracket.

Senator Hollett: Mr. Hart, you said that the more money we have then the more we are going to spend, and that is inflationary. Under the White Paper the money is going to be taken from us by the Government—perhaps by the banks too. Would not that be inflationary as well? The Government is going to spend it.

Mr. Hart: Absolutely. That is the point I was trying to make earlier.

Senator Hollett: What is the difference between the Government's spending the money and the people's spending it?

Mr. Hart: Well, we are getting into the political arena here, and I do not know whether I should engage in such a discussion. I am not in favour of socialism, if that is what you are trying to get me to say.

Senator Hollett: Or, the more money that the banks have...

Mr. Hart: Why are the banks singled out? We are not spending the money.

Senator Hollett: I cannot see how the taking away of money from the ordinary individual is solving the problem of inflation. You are going to take the money from the people and put it in the banks, and the Government is going to take it, and lend it out and spend it. Well, that is inflationary too.

Mr. Hart: You keep mentioning the banks as though we were the bad boys in the picture. I like to think that the savings or the deposits with which the banks are entrusted by the public are used for productivity purposes in the economy of the country.

Senator Hollett: That is true, but you are spending it, and that is inflationary.

Mr. Hart: No, it cannot be inflationary in that respect, because we are spending it to produce income. We are not spending; we are lending other people's money, in effect, to improve the economy of the country. We are lending money right across the country and to all types of operations—farming, corporations, mining, individuals, and so on. I do not think you can say we are spending it in that way.

We are lending money for the good of the country.

Senator Hollett: Mind you, I am not in favour of the White Paper either.

Mr. Hart: Thank you, sir.

Senator Molson: Mr. Chairman, I should like to ask Mr. Hart to look at page 14 of his brief. He is dealing here with the bottom scale of the impact of income tax, and he suggests a system of tax credits rather than a system of exemptions. This is a thought that has been developed previously before this committee, and I think it might be useful to have it developed further.

Mr. Hart, is it your thought that some number be arrived at which would be the basis of an exempt sum for every taxpayer regardless of where he fits into the scale? Would you develop this suggestion here?

Mr. Hart: Mr. Chairman, in answer to that question I will say that the tax credit, first of all, is quite different in principle from the exemption. I am arguing, of course, that the exemption favours those in the higher income tax brackets. This, I think, is accepted. On the basis of a tax credit everybody is treated in the same way. Now, you can vary the tax credit if you wish for various income groups, and in whatever way the Government decides, but you are not favouring anybody particularly as you are under the exemption system, and which is done unwittingly, I am sure. But, this is the way the mechanics work out: The higher up the income scale then the better off you are, and it should be the reverse, I submit. The lower you are, then the more relief you should get.

Senator Molson: Your principle being, then, that the tax is calculated, and then there is a credit given?

Mr. Hart: That is right, there is a credit given.

Senator Molson: So it is a deduction from the tax payable rather than a deduction from the income?

Mr. Hart: Yes.

Senator Beaubien: It would be a deduction on an escalated scale?

Mr. Hart: It could be, yes. It would be very simple, I would think, for the Department of National Revenue or the taxing authorities to

adjust these tax credits from time to time, depending upon the amount of revenue that is required, or for whatever other reasons they might wish to change the income tax figures.

Perhaps I might ask Mr. Currie if he has anything to add to that.

Mr. N. E. Currie, Vice-President and Economic Adviser, Bank of Montreal: Senator, I think the essence of the tax credit proposal is to try to get rid of several of the anomalies that there are in the present situation. One is, as Mr. Hart has mentioned, that the present system of exemptions is such that as you move up the progressive scale you can get progressively more benefit from the exemption or the deduction for another dependent. Of course, this necessitates under our present income tax arrangements a readjustment of the progressivity of the tax structure itself to compensate for that. In fact, our nominal tax rates are probably more progressive now than they would otherwise be without the exemption, because they have already been adjusted in such a way as to take some of this benefit away from the results of this exemption system, working up the scale.

It is true that you could work out a specific scale for any given taxpayer in terms of the numbers of dependents. Let me take as an example a married taxpayer with a dependant spouse. You could work out one scale under the tax credit system which would achieve exactly the same results as under the exemption system, as long as you are dealing with one class of taxpayer in terms of numbers of dependents. The problem is that having done that you then move across to consider what the effect is on a taxpayer with a greater than average number of dependents, or a lower than average number of dependents, and you produce anomalies, such as the effect of progressivity.

The scale under our present arrangement is more and more onerous on people with a less than average number of dependents as you move up the scale. The contrary is also true. If you have an above average number of dependents you get more benefit from the thing.

Now, it is possible—and it is really not terribly technically difficult, I understand—to devise a system with tax credits such that every dependent qualifying for an exemption would be worth as much in terms of tax credit for every taxpayer regardless of where he is on the income scale, and regardless of how

many dependents he has. Of course, it would be proportional to the number of dependents.

There are some puzzles at the moment. It seems to be an extraordinary situation. No matter how often you adjust the progressivity of the scale, after they have changed the exemption rate, you still have this puzzle on either side of the average number of dependents. For instance, if you have ten children then the more money you make the better off you are in terms of exemption.

I think that is all I have to say.

Senator Benidickson: The overriding difficulty, of course, is that in the absence of a negative income tax we cannot do anything about the large group of people who are not taxable. No approach to exemptions or tax credit will be effective for all.

Mr. Currie: Although this suggestion is not put forward in Mr. Hart's brief and is not dealt with at all, the literature suggests that if as a matter of national policy we are moving in the direction of a negative income tax it would be much easier to graft on to a tax credit system than an exemptions system.

I am not necessarily suggesting that it is desirable. Other problems arise with regard to incentives and that sort of thing with a negative income tax.

Senator Everett: Mr. Currie, what are the dependants' deductions now beyond the basic exemption under the Income Tax Act?

Mr. Currie: Do you mean children entitled to family allowance?

Senator Everett: No, the basic exemptions.

Mr. Currie: It is \$1,000 for an individual, which it is suggested should be increased to \$1,400.

Mr. Hart: It is \$1,000 for a married man and a certain amount for each child.

Senator Everett: We have a room full of chartered accountants. Perhaps one could help us.

Mr. R. D. Brown, The Canadian Institute of Chartered Accountants: The individual's personal exemption is \$1,000; a married person, \$2,000; dependants under 16 years of age, \$300; other dependants \$550.

Senator Everett: Thank you, sir. If the child becomes eligible for family allowance the deduction is reduced from \$550 to \$300; is that correct?

Mr. Brown: It is on an age basis, \$300 for a child under 16 and \$550 for a dependant child or any other dependant over 16 years of age.

Senator Everett: Is that not a recognition of the principle you establish here? It is a form of transfer payment, because there the loss of deduction of \$250 bears more heavily. The antithesis is true of your initial argument that the loss of deduction bears more heavily on the high as against the low income tax payer.

Therefore this is another method, by reducing a deduction, of arriving at the same system that you are suggesting. Is it a valid form as compared to your tax credit form?

Mr. Currie: Some of the computations of changing benefits would be removed if there were a tax credit system.

The difficulty now is that this in fact acts as an inhibition on the tax authorities to change the basic exemption level for instance, or the deduction per dependant very frequently in the face of inflation or for any other reason.

Once the exemption is changed everything above it is altered because of the progressive effects of the exemption or deduction as you move up the scale.

With a tax credit system the adjustment of the pure amount of credit per dependant would not affect the progressivity of the scale at all. Therefore it would be a matter of an overnight decision without any reconstructing of tables. A decision is made to exempt \$2,000 or whatever the amount of income is, by the tax credit. All in the system receive the same degree of benefit.

Senator Everett: It is an extension of the scheme of reducing the deduction from \$550 to \$300, which is another way of defining the same approach, except that it goes all the way.

Mr. Currie: Yes. The family allowance adjustment you referred to is a once-and-for-all deduction. It is a discreet adjustment which takes place at a particular age.

Senator Everett: The Welfare Council of Canada made a similar suggestion to us last week. They suggested it be done by allowance payments rather than tax credits because, of course, their interest is in those in the lower income scale who pay no tax.

Senator Cook: The more general and economic effect and the regional impact are referred to on page 29 of your brief.

You speak of two aspects which I consider very important: one is the taxation of small business; secondly, the effects on the natural resource industries.

Speaking generally, would the abolition of the lower rate for small business not have the effect of seriously interfering with the ability of new, small businesses to borrow?

Mr. Hart: Yes, I think it would have an effect on their ability to borrow.

I do not know whether "seriously" is quite correct, but it should have some effect. It would be more serious for some businesses perhaps than others, but there are other factors in the borrowing system.

Senator Cook: But it certainly would affect the relationship between the company and its bankers because of the fact that the company would be adversely affected.

Mr. Hart: That is right. They would not be retaining as much income for the growth of the business. The potential for income is as important as the ability to borrow. There is a combination of the two.

Senator Cook: You speak of the effect on the extractive industries. We have had evidence that approximately \$2,000 million has been invested in the iron ore industries in Labrador, such as Brinco and in general. It was suggested that this amount would not have been invested had the White Paper proposals been in force.

I draw that to your attention to bear out your statement on page 29 with respect to the effect on the less developed parts of Canada, which to my mind is very serious indeed. Similar evidence was put forward by the Bethlehem Copper Company of British Columbia and with reference to the tar sands.

Mr. Hart: I agree wholeheartedly, of course, senator, with what you say.

Senator Benidickson: Reference is made in the brief tax spreading versus exemptions in relation to tax credits.

The press release of the Minister of Finance of March 6 is mentioned. If that press release is not part of our record it should be made so.

The Acting Chairman: Very good, we will see to it, Senator Benidickson.

Senator Benidickson: I would just like to make a note of that. We have had references

to it from time to time; the Minister of Finance has argued that exemption had some preference over tax credit, and I think when we are discussing tax credit we should have that in our minutes.

The Acting Chairman: We will see that the staff get that into the record. I wanted to follow through Senator Cook's point, who anticipated me on the small business item. I go back, Mr. Hart, specifically to page 6 of the brief, which deals in paragraph (d) with the subject of small businesses and the necessity of encouraging "the establishment of growth of economically and socially useful small business". I will not read the whole paragraph. With your background and experience, I am sure honourable senators would like a reaction to the following question. There seems to be considerable support for the suggestion that the lower rate of taxation presently in existence be applied only to businesses whose earnings, say, do not exceed \$75,000 to \$100,000; or put differently, that the lower rate should apply only to the category of small businesses defined on the basis of taxable income in a given year rather than sales, capital investment and all that sort of thing. Would you be good enough to give us your views on that?

Mr. Hart: It would probably be a very simplified approach to it, I should think, but would it not tend to produce other anomalies? The point I am trying to make here is that in the attempt to remove this favourable tax treatment of small businesses, nothing has been suggested to take its place, and I think it is wrong in principle that they should be penalized at this particular time, or any time really, because we have had this for, I believe, 20 years now.

Senator Molson: That is the suggestion.

Mr. Hart: Certainly there has been some abuse. I think they have closed up a lot of the loopholes, as I understand it. Under any system there will continue to be abuses of some kind, but why should everybody have to suffer for the sake of a few?

The Acting Chairman: I think you may have missed the point. The view is entertained that the benefit of the lower rate should not be given to all corporate taxpayers—we will leave out partnerships for the moment—but rather that the benefit of the lower rate should be given only to a group of taxpayers defined having regard to their tax-

able income in a given year, say \$75,000 to \$100,000. The way we have it now, I do not have to tell you, the benefit goes to everybody.

Mr. Hart: Everybody gets it.

The Acting Chairman: And a good many who do not particularly need it.

Mr. Hart: I cannot really quarrel with that. It might be a bit arbitrary in its application. How do you fix the amount? You say \$75,000 or \$100,000. Should it be \$200,000? I do not know.

The Acting Chairman: What do you think of the principle of isolating a group of corporations defined as small businesses, and the lower rate applying to them only and not to all corporations?

Mr. Hart: I would not be opposed to it, because I think the burden is certainly on the banking system, for example, to assist small business to the greatest extent possible. We are in fact urged to by the Governor of the Bank of Canada from time to time, and we tell him that we are making every effort to help small business, particularly in areas of the country where they are suffering, where their economy is not as good as other parts of the country. If this is the means of retaining a preferential treatment for small business, I could not object to it. I would far rather have that than throw the whole thing out of the window.

Senator Hays: Would you care to advise the committee at a later date how you would define "small business"? You are very familiar with it. You deal with small business across the country, and are probably more able than anyone else to suggest how it can be defined.

Mr. Hart: It is very difficult to define, I would think. We could certainly take a crack at it, and I would be glad to attempt to do so. It is like trying to define the word "bank" or "banking", which was attempted by the royal commission and finally given up as hopeless. There are so many factors that enter into what determines a business as small or large. It might be a little awkward, but we can certainly try.

Senator Molson: Following that, if the system that has just been suggested as of assistance to small businesses is not adopted and some of the other proposals are adopted,

such as the special capital cost allowance, again we shall have to have a definition of "small business", so the difficulty does not arise only if this particular suggestion is followed through; we will get it anyway if anything is done for small business.

Mr. Hart: It will be very difficult to define, I think.

Senator Hays: Would you attempt it?

Mr. Hart: We would certainly try, since you have asked, senator, yes, but I submit that it will be very difficult. If I might defer to my colleague, have you any comments on that, Mr. Currie?

Mr. Currie: Not really. As Mr. Hart says, it is very difficult. You either define it in relation to income, or, as the Chairman mentioned—and presumably you have had discussions about this sort of thing in the committee before—in relation to sales. One suggestion I have heard is to have it in terms of cumulative earnings over a number of years; once a certain cumulated figure is reached you cut off the benefit of the lower rate. All these definitions run, in my view, into the same kind of problem, which is one of the objections raised in the White Paper to the present system—the problem of proliferation.

I have not really thought it out, but if you make the tax benefit available only to small incorporated business defined in some way in relation to income, you get to a point where you either inhibit the growth of that small business, otherwise they become taxable at the full rate, or alternatively you wind up at that spot and start all over again. So you could have a tendency to artificial creation of new small business along the lines of the abuses that are inherent in the present system, but which, as Mr. Hart said, have been largely and progressively closed over the years as they have opened up. I cannot think right now of a clear definition of "small business" that would be applicable to your suggestion, Mr. Chairman.

Senator Hays: Representing a group of bank managers across Canada in every city, you would probably be best able to define "small business".

Mr. Hart: We would certainly make the effort, but it will be difficult.

Senator Hays: Is a farm a small business?

Mr. Hart: Not necessarily. Some of the farms are tremendous businesses.

Senator Hays: Is a poor business a small business?

Mr. Hart: He may be small just because he is a poor businessman. In the hands of somebody else, another entrepreneur, it might be highly successful. There are all sorts of ramifications to this.

The Acting Chairman: Now we move over to the delightful subject of capital gains, which you deal with in your brief. Before we discuss your suggestions, I should like to state the following. Views have been expressed with respect to capital gains, (a) that in a country such as ours we are a little premature; (b) that if we were to have a capital gains tax then we should follow more or less the system now in force in the United States because of the latter's experience over a period of years, and (c) there has been an expressed opinion that if we were to have a capital gains tax we should have a mere flat rate not to exceed 25 per cent.

For the present, as a transitional move and in order to test it out, we would simply apply a capital gains tax against realized profits made in respect to the acquisition and sale of securities, but also including land and real estate investments such as building and the like. In other words, under item (c) we would deliberately eliminate all troublesome minor items, such as objets d'arts, paintings, homes, farms and all that sort of thing and just start off with a simple capital gains system and test it out in the early stages. I am sure honourable senators would like your views on item (c).

Mr. Hart: Mr. Chairman, I think there is much to be said for testing a capital gains tax, but if they are going to introduce it the difficulty I should think would then be on whom do you place the burden of the test? Why do you single out certain segments of the economy for this and not have it apply to everyone?

You mentioned objets d'arts. I hope that would be out entirely, because that involves tax on unrealized capital gains, which I am opposed to. Realized taxable gains is fine if the tax must be introduced. As I said, I have done a lot of soul searching, but in the final analysis, if it is going to overcome some anomalies which exist now for the benefit of the country, I would be in favour of a tax on

realized capital gains. It is fine if you can test the waters, and perhaps we should, but it is entirely new for this country.

We have always prided ourselves in the fact that we have no capital gains tax. We are a developing country still heavily dependent on capital for our growth and development. This is what caused me to do some soul searching. Perhaps we are reaching a stage now in relation to what the experience has been in other countries that we could perhaps afford a capital gains tax properly administered. I would be a little reluctant, apart from the desirability of testing it, as to how you are going to select that body of people in the economy who are going to suffer the impact.

The Acting Chairman: The thought is that we want to give you the benefit of the views which have been expressed before this committee. The feeling is that one should not tax a farm and a homestead associated with it as long as the farm and the homestead move from buyer to seller and continues as a farm. With respect to an individual home in the city, the feeling is that there obviously should be a roll-over provision. There is no common market for such commodities as farms, orchards and that sort of thing. There is no such thing as a buyer and seller in the open market.

If you get the same point of view with respect to objets d'arts and incidentals such as paintings, some furniture, et cetera, there is a tendency to come to the conclusion that if we are to eliminate by way of exemption a number of items which obviously should be exempted or in respect to which there ought to be a roll-over provision, would it not be simpler for a young country such as Canada, as we made into the cold waters of capital gains, to apply the tax where the costing and receipts can be simply filed easily by relating it to listed securities and by reference to real estate, always keeping in mind other items not covered by the capital gains. If we had taxpayers who were moving in and out in acquisition and disposition we would be dealing with traders. In any event, they would be subject to normal rates of taxable income.

Mr. Hart: I think I see the burden of your argument. Of course, it is on the basis that there is a market for these various items you have mentioned that you can then assess the actual gain which is realized. There is a market there whereas there is not for a small farm or a small house in various parts of the country. To that extent, it is a very good

suggestion that if this is the way we are going to go we should test the waters first.

The Acting Chairman: A number of senators have points of view as to whether or not we are too young a country for capital gains. A number of representations have been made to that effect. My question (c) was based on that assumption.

Are there any other questions that anyone would like to put in regard to this question of capital gains? Mr. Hart, I would like to put one or two questions to you which you may not wish to answer.

Senator Burchill: Are you leaving the question of capital gains? I would like to ask Mr. Hart that if we decide to have a capital gains tax would he prefer a separate tax or a tax integrated with the suggestions in the White Paper.

Mr. Hart: I would certainly prefer a separate tax. People should realize what they are being taxed for and taxed on.

The Acting Chairman: I think I can speak for all senators in saying that this committee has been as apolitical and objective as possible in the study of the representations which have been made to it. With that background, I should like to tell you that we have had very important taxpayers in this country who have as responsible companies, through their spokesmen, taken the position that if the White Paper in its present form, or if the hard core or thrust of it were implemented in legislation it would aid and slow down the economic development of our country in terms of rate of progress, and it would retard the amount of foreign capital coming into our country. Based on your tremendous experience—I know you are here as an individual—we would like to get your opinion as to whether the reactions are overstated or whether the statements which have been made by some of the most important concerns of this country should be accepted at face value.

Mr. Hart: Mr. Chairman, I am grateful for the opportunity to speak to this because I know it has caused a great deal of concern across the country. In fact, on page 32 of my brief I do touch on this important implication for the economy of the country as a whole. It is the first paragraph commencing on that page. I am trying to bring out the points as to how Canada would suffer. Capital would no longer be attracted to this country from

abroad. I still submit that we need as much capital as we can lay our hands on if we want to continue the standard of living we have become accustomed to over the many years.

I have mentioned only briefly the mining industry, because I am not an expert in that field. From the briefs I have read and the suggestions which I have heard it is quite obvious that the impact of the proposed tax reform in the White Paper would bear more heavily on that one than any other industry. The mining industry has been tremendously important to Canada and it has attracted outside capital. Why, because I think our tax treatment has been favourable and it has encouraged people to invest in the country and promote the growth of the country. We have all benefited from it. I am not one of those who looks down his long nose on foreign capital. I think we needed it and I do not feel we would be where we are today if we had not had foreign investment. I hope nothing will discourage capital from coming into this country. It has been good capital and not fly by night. From the point you have raised I wholeheartedly agree that the proposals put forward in the White Paper would have a serious effect on the economy of Canada if they were implemented.

The Acting Chairman: Internal in terms of the expansion by companies now here.

Mr. Hart: That is right.

The Acting Chairman: And external from the point of view of foreign capital flowing in.

Mr. Hart: I think the statement made earlier by Senator Cook is true, that a lot of this development in other places would not have taken place if we had a tax system such as that proposed in the White Paper, particularly in the mining industry. We would not have had a Churchill Falls, we would not have had a Bethlehem Copper, and many other things I can think of. It just would not be feasible. Capital is pretty tricky. Capital is going to move where it will get the best treatment. Capital is going to go where it will get a reasonable return, where it is going to be as risk free as possible. If we close the door to it, it will be a long time before it opens up again.

The Acting Chairman: That is the advantage of a clear answer to what I hope is a clear question. I would like to put one further question to you. That is, going back to the

important point of inflation. Aside from the obvious deleterious effects that it would have on people with fixed income and the like and all the serious consequences flowing therefrom, would you concur in the view expressed here, that the continuance of the inflationary spiral, or its aggravation if the White Paper were implemented, would be particularly serious for Canada, because of it being an export nation of great consequence, in relation to a mere population of 22 million? In other words, with our great export trade, the inflationary problem becomes much more serious for a country such as ours? Do you support that statement?

Mr. Hart: I certainly do, Mr. Chairman. If we are going to impose a heavier tax burden on the economy of Canada, we are simply inviting people to protect themselves by increasing the costs of their services or the goods which they produce and, as you so aptly pointed out, Canada is heavily dependent upon foreign trade—much more so than the United States, our neighbour to the south of the border, for example. If we are going to price ourselves out of the market, I think it would be a very foolish step on the part of Canada. In the international field, again, countries are going to buy where they can get the types of products they want at the most favourable price and the best deal. This is purely competition.

Senator Beaubien: Mr. Chairman, I regret I was out of the room when Mr. Hart started talking about foreign capital, and I should like to refer back to that and to ask a question. Mr. Hart, you are very familiar with the Anglo-Newfoundland situation. How much money has been invested so far in the Churchill Falls area by that group and at what price did the stock come out, eight or nine years ago?

Mr. Hart: I do not know whether I am in a position to disclose any information about a bank's customers.

Senator Beaubien: I want just what is publicly known.

Mr. Hart: There was a figure mentioned the other day by Mr. Mulhall, the President of Churchill Falls. I think it was something in the order of about 250 million dollars that has been spent so far.

Senator Beaubien: Roughly how much more, Mr. Hart?

Mr. Hart: They talk about \$1 billion for the whole thing. \$750 million, roughly, say, to be spent yet.

Senator Beaubien: I want to ask this question. As to the people who are talking about foreign capital in a disparaging way, and so on, and suggesting that we should control everything in Canada, would it not be a good idea, if someone were to ask them whether they could possibly get the \$750 million to take over Churchill Falls? I am sure that the people who have already put up the \$250 million would be very glad to make a deal and sell it to any group in Canada who want to finish the project.

Mr. Hart: Part of the financing that was done, senator, as you may recall, was the issue of first mortgage bonds of the order of \$550 million. Of that amount, \$500 million was placed in the United States and only \$50 million in Canada. Without that, you would not have had a Churchill Falls.

Senator Beaubien: And the common stock came out at ten dollars.

Mr. Hart: Yes. I did not follow the market on it. It has been four or five.

Senator Desruisseaux: Mr. Hart, last December, in your address to the shareholders of the Bank of Montreal, which you mention at page 34 of the brief, you said that if the White Paper were implemented it would effect radical changes in the economic, financial and social structure of Canada. You spoke at that time to a large audience and that speech of yours was repeated all over Canada. You were quite implicit about what the White Paper could do to the economic situation in Canada. In the days after that, did you get many adverse reactions to your statements of what it would do?

Mr. Hart: I am happy to say, Senator, that I do not recall any adverse reaction I got, whatsoever. As a matter of fact there were a lot of letters from various parts of Canada particularly with respect to small businesses. They were concerned about that. As you may recall, our annual meeting is early in December and the White Paper had only been out a couple of weeks. I had to go through it pretty quickly. The first impression I got led to those remarks and the more I read it the worse it became, in my opinion, hence the fact that I

thought I should attempt to file a brief before this committee to explain some further points.

Senator Desruisseaux: Was it generally accepted in your mind that as far as the reaction is concerned your views on the implementation are confirmed?

Mr. Hart: To that extent I guess I could agree, senator. There may have been adverse reaction. I did not hear it, if there was. Do you recall any, Mr. Currie?

Mr. Currie: Not particularly, except from the spokesmen for the Government.

Mr. Hart: Well, yes, you would expect the Government to oppose, yes.

The Acting Chairman: Are there any further questions, honourable senators? If not, we will close this presentation. We are very grateful to you, Mr. Hart, and to you, Mr. Currie, for being here today.

Mr. Hart: Thank you, Mr. Chairman and honourable senators, we are very glad to have been here today.

The Acting Chairman: Honourable senators, we turn now to the brief by the Canadian Institute of Chartered Accountants. We have here Mr. W. E. Goodlet and with him are Mr. McIntyre, Mr. Huggett, Mr. McLaughlin and Mr. Brown.

The Acting Chairman: Honourable senators, we have before us now this very important Institute of Chartered Accountants. I understand that you will be leading off Mr. Goodlet. Will you be good enough to summarize your brief and your general thrust.

Mr. W. E. Goodlet, the Canadian Institute of Chartered Accountants: Would it be in order, Mr. Chairman, to say at this point that we did not intend to summarize our brief because of the size of it. Therefore I have prepared a very short opening statement which will merely explain our background, and we will let the brief speak largely for itself. That is with the exception of one or two highlight points I will make.

First of all I would like to explain the background to the Taxation Committee of the Canadian Institute of Chartered Accountants, which is the body to which all 18,000 Chartered Accountants belong; and includes members in industry, in government and in education as well as those in public practice.

The Taxation Committee is made up of a group of Chartered Accountants with considerable experience in the practical application of tax legislation. They are drawn from various geographic areas, from firms of varying size and from industry. This provides a broad range of experience and opinion, but, in order to broaden this range still further as far as the White Paper was concerned, we asked for and received the views of the Taxation Committees of the various provincial institutes. All in all, about 200 tax oriented Chartered Accountants contributed their thoughts towards the preparation of this submission. In the final analysis, however, the views expressed in our submission are those of this committee alone and we must accept responsibility for them.

We believe our recommendations, based as they are on the views of people skilled in the practical application of taxing statutes and who are exposed on a continuing basis to the reactions of taxpayers generally, are worthy of special interest.

In our approach to the White Paper, we did not attempt to develop what we thought might be the best tax system but, rather, started with the White Paper proposals and considered those areas of the proposals where we thought modification was essential. There are many parts of the White Paper that we support and, for those proposals that cannot accept we have presented what we believe to be practical alternatives.

I do not intend to recapitulate our submission which covers the whole range of the White Paper proposals but there are a few points I think should be made at this time.

In the area of individuals, we support the Minister's desire to provide relief for the low-income groups but we are concerned with the weight of taxation that will be imposed on the \$10,000 plus income groups, and we believe very strongly that the lowering of the top rate of personal tax to approximately 50 per cent should take effect immediately on implementation of the new system both on the grounds of equity and to ensure that the new system will function effectively.

In the area of capital gains, we are prepared to support the full taxation of short-term capital gains, but we believe long-term capital gains are deserving of less onerous taxation and that special rates should be provided on Canadian share gains as an incentive towards Canadian ownership of Canadian shares.

We are also firmly convinced that the introduction of a capital gains tax requires that the recent estate tax legislation be substantially modified. We cannot recommend the introduction of a capital gains tax of the size suggested in the White Paper and even in our own submission without very substantial modification to the estate tax legislation.

In the area of corporate and shareholder integration, while we cannot support the form of integration proposed, particularly the line of distinction drawn between widely-held corporations and closely-held corporations, we believe that some modification of the proposal will give some recognition to that part of the corporate tax that may be borne by shareholders and will provide important incentives to Canadian ownerships of many Canadian corporations—not all, but many.

In the area of business income, we very strongly oppose the proposed treatment of goodwill on two grounds. First, we are quite unconvinced of the validity of the concept of depreciating goodwill, and, secondly, the proposed treatment of goodwill results in great complexities and serious inequities in other related areas—particularly in the area of closely-held corporations, and the provisions suggested in the White Paper to deal with that problem.

In the international area, we are concerned that the White Paper proposals would inhibit the ability of Canadian corporations to expand abroad and would restrict the transfer of skilled personnel between different countries.

In conclusion, we welcome the opportunity to present our views on the proposed tax reform and my colleagues and I will do our best to answer any questions you may wish to put to us regarding the brief we have submitted.

What we have done is this; we have divided the brief up into sections on which certain members of this group have concentrated their efforts, so that if it is permissible I will be prepared to direct the questions to those people who have undertaken to answer questions in specific areas.

Senator Beaubien: Mr. Chairman, I would like to ask the panel what about the five-year capital gains tax?

Mr. Goodlet: This is the five-year revaluation, senator?

Senator Beaubien: Yes.

Mr. Goodlet: I think we rejected this out of hand, pretty well. I think Mr. Huggett can deal with that for you.

Mr. D. R. Huggett, The Canadian Institute of Chartered Accountants: We feel, senator, that this five-year revaluation is completely unfair, and we suggest that it be abolished or that it not get into the law in any way, shape or form. It will have effects on controlling lots of shares of companies; it will have effects on non-residents and it is our feeling that it should not be introduced.

Senator Beaubien: But, Mr. Huggett, if we do not get the five-year revaluation on capital gains, how could the federal Government finance the reduction from the top rate of 84 per cent to 50 per cent?

Mr. Huggett: Well, of course they already have a fairly substantial revenue increase and the elimination of the five-year revaluation could come out of that amount of money. But our brief does suggest that as a trade-off for the abolition of the five-year revaluation, there be a deemed realization of capital gains on death, and that those taxpayers when they die would be required to cough up the capital gains tax at that time.

Senator Beaubien: But if you are going to abolish estate duties, does the Government get any added revenue from this system?

Mr. Huggett: They would get the capital gains tax revenue at that time.

Senator Beaubien: Of course the estate taxes mainly go to the provinces anyway.

Mr. Goodlet: Yes, and estate tax is not, I think one of the more significant revenue raisers except in exceptional years.

Senator Beaubien: But still the reduction of the top bracket from 84 per cent to 50 per cent will mean quite a reduction. Unfortunately we do not have our expert with us to say how much it will cost.

Mr. Huggett: Well, senator, the estimate contained in the White Paper is that the reduction of the top rate of tax down to 50 per cent would cost only \$40 million. That is the estimate provided by the Government itself in the tables, but I forget which table it is.

Mr. Goodlet: It is in table 15 on page 95 of the White Paper. In the fifth year they sug-

gest that there will be a drop of \$40 million as a result of the reduction of the top rate.

Senator Molson: Mr. Chairman, I would like to ask a very general question before we get into the more detailed part. Do the representatives of the Institute feel that the proposals in the White Paper as set forth could readily be implemented, taking into consideration the mechanical demands on the individual and on the corporations which would follow from the White Paper. Now I do not want to suggest for a moment that this would not give a great deal more occupation to the members of the Institute, but leaving that part aside for the moment, what do you think about it?

Mr. Goodlet: Speaking from the point of self-interest, senator, as you have suggested, we could do very well out of this whole exercise. I think we would have no problems. But I think our concern is more on the mechanical implementation of this, and it would be more on the side of the Government than the Department of National Revenue. We are concerned that this would require both an expansion in numbers of staff and in quality of staff, upgrading of staff, in some respects, to provide answers which would be required very quickly in making business decisions, if this is not to inhibit normal business practices, and business take-overs and reorganizations, in particular.

I think in the area of the larger corporations, this should not cause too serious a problem. Where it will have a more serious impact, I suggest, is in the area of the smaller corporation where they do not have the highly skilled professional staff to deal with some of these matters. They will have to rely on professional advisers, such as accountants and lawyers, to help them out, with increasing cost to them. I suggest the big strain would be imposed on tax advisers, tax consultants and the tax administration.

Senator Molson: Do you not think also that the strain on the individual is going to be really quite severe?

Mr. Goodlet: Do you mean, as far as what I might call the ordinary taxpayer is concerned, the person on a wage or salary income?

Senator Molson: The ordinary taxpayer. As a matter of fact, we have had a lot of discussion on the impact of these proposals on the middle group who are numerically large and

who, it is suggested, are going to bear the brunt of the increased effect of the White Paper. I do not think most of those people can make up their income tax return without expert advice. This is my personal point of view. I am asking you for an opinion on it.

Mr. Goodlet: I would agree. There are many people who are presently capable of making up their own income tax return who would find it impossible to do so because of the record-keeping necessary, and they would require professional assistance, whereas previously they did not have to have it. I think of those with investment portfolios, in particular.

Senator Molson: And those could be in the thousands.

Mr. Goodlet: Oh, yes.

Senator Benidickson: It appears to me, in reading the brief, that perhaps you make a point different from most of the representations we have received here with respect to double taxation, or integration of the tax on corporations and personal tax. I think you, more than anybody, raise some doubts, or present the argument of doubt as to whether or not the corporation tax is really borne, for the most part, by shareholders. Of course, there are those who indicate that in their opinion a great portion of the corporation tax is advanced to the consumers in the form of increased prices and, to that extent, it is not directly borne by shareholders. For that reason you rather question the necessity at this time of giving full credit for a corporation tax such as would follow from the treatment of a closely-held corporation, and the assumption of the 50 per cent personal income tax rate. Would you like to elaborate on that?

Mr. Goodlet: I would like to refer that to Mr. Huggett, who is specializing in that particular area.

Mr. Huggett: Yes, senator. There has been a number of studies made—not, to the best of my knowledge, in Canada but in other parts of the world, particularly in the United States—trying to determine who bears the corporate income tax. Really, all these studies have proved is that the evidence is inconclusive as to who actually bears the tax. I think we probably believe that the shareholders of the large public companies do not really bear the tax. If taxes are increased, then the tax increase may be passed on to the consumers;

it may be passed on to suppliers and others; although, to a certain extent, I suppose some is borne by shareholders. However, we just do not know exactly where the burden falls. On the other hand, we feel that for the smaller companies, then perhaps a greater proportion of the corporate tax is borne by the shareholders of those companies.

Senator Burchill: I do not know whether this is the proper time to ask this question or not, but you can rule me out of order if you wish, Mr. Chairman.

There has been general agreement, I think, that the proposals embodied in the White Paper are going to generate more money for the Government, but there is a great difference of opinion as to how much more money. We have heard the opinion of the province of Ontario, which does not agree with the estimates put forward by the department. Has the Institute made any studies on this point, and, if so, what is their opinion?

Mr. Goodlet: No, senator, we have not made any studies on our own in this respect. The work and effort involved in producing these statistics is something beyond our present capacity as a small group on the taxation committee, such as we are; but we are very concerned, as I am sure everyone is, as to the varying estimates of the amount of additional revenue that will be raised. In our brief we suggest that we would prefer to see the rates introduced as if the system was mature and a small surtax used to pick up the necessary revenues if there should be a short-fall, rather than, as appears to be the situation, budgeting for an increase in revenue generally, which is estimated variously, as you have indicated, by the Government of the Province of Ontario with quite different answers.

Senator Benidickson: Mr. Chairman, on a technicality, I want to raise a point with Senator Burchill. We have not heard from the Province of Ontario. We have read some of their estimates, and it raises the question whether or not the working papers, which were apparently made public last weekend, in some way should come before this committee. I do not know that we can call representatives of the Ontario government, but the papers are a public document and it would be of interest to our technical staff, because so far all we have officially is the reference in the White Paper as to the extent of the increase in total revenues.

The Acting Chairman: Your observations, Senator Benidickson, will be brought by me to the attention of Senator Hayden, with a view to possibly bringing the figures into the record.

I would like to direct one major question to this group—a vital question, in my opinion. It flows from Senator Benidickson's question as to whether really shareholders bear the brunt of corporate taxation. In dealing with the subject matter of necessary reforms in our tax structure, are you approaching your suggestion from the point of view of the acceptance of the White Paper in principle and suggesting modifications to the ultimate drafting of the legislation that would implement the White Paper? Or are you taking the position that the cold thrust of the integration system has not been carefully, properly, and completely thought out, and that reform for the present should be restricted to a series of amendments to the present Income Tax Act? How are we to deal with your thinking?

Mr. Goodlet: Mr. Chairman, I do not think that we had considered this in the aspect in which you have suggested it, but it seems to us that there is not that much change that would be required. The present income tax could be modified, even with the proposals in here, but there will be a completely new substantive piece of legislation, so, in effect, it will be a new income tax act eventually.

The Acting Chairman: Admittedly so. Then, we will come back to one basic point. Do you in principle, as an institute, believe in the concept of integration as distinguished from the current system of corporate taxation and tax credits to the shareholders?

Mr. Goodlet: I think Mr. Huggett has spoken to that already.

The Acting Chairman: If he has I have not picked up the conclusion.

Mr. Goodlet: We are in considerable doubt as to whether the integration concept as such—in other words, the integration of personal and corporate taxes—is a valid one if one starts from the assumption that the corporate tax is borne by the shareholders. There have been many studies, as Mr. Huggett indicated, mainly by economists in the United States, although some elsewhere, attempting to determine who in fact bore the corporate tax. The general conclusion appears to be that it has shifted in some degree forward to consumers, and in some degree backward to sup-

pliers, and in some degree to employees, or to the wage structure, and that some portion is borne by the shareholders. But, there is absolutely no consensus, so far as I can determine, as to the degree in which it is borne. In fact, I saw one study that suggested that the corporate tax had shifted 110 per cent.

The Acting Chairman: Do you conclude, therefore, from that general statement, that this institute, which, after all, is closer to the taxpaying public than lawyers are, is suggesting that we should retain the present system of corporate taxation with the 20 per cent tax credit?

Mr. Goodlet: No, our proposal is a partial integration proposal, and I would ask Mr. Huggett to speak to it.

Mr. Huggett: If I might amplify the chairman's remarks I would say that we have examined the existing system, we have examined the question of deducting dividends from income, and we have examined increasing the dividend credit, and basically we have rejected these and we have accepted the general thrust of the White Paper that there should be some integration of the corporate and personal income taxes.

Now, we have rejected the dividend tax credit—the existing credit—because we feel that it is imprecise as outlined in the White Paper. Larger benefits go to high bracket taxpayers and, therefore, the credit is worth more to them. We feel that the dividend credit, without any reference to the corporate tax paid, can be costly in revenue terms.

Senator Everett: Excuse me, but do you say that under the tax dividend credit method larger benefits accrue to the high tax payer?

Mr. Huggett: Yes.

Senator Everett: How do you come to that conclusion?

Mr. Huggett: Well, if you have, let us say, a dividend of \$100 then there is a net benefit to the high bracket taxpayer of \$20. Now, to get \$20 after tax he might have to earn \$40, \$50, or \$60. Whereas the low bracket tax payer gets a net \$20, the same amount, and he may need earn only \$30 in order to get that same after-tax amount. That is how we arrive at our conclusion in that regard.

Senator Everett: But does not the fact that the dividend credit, as a deduction from the tax itself rather than from taxable income, tend to minimize the difference?

Mr. Huggett: I would suggest that it tends to magnify the difference.

Mr. Goodlet: Perhaps I could add to that. If one assumes that we are giving the credit because of the corporate taxes that were borne, then the amount of income that the shareholder really receives is not \$100 but \$120, of which \$20 has been withheld at source, or deducted by the corporation on his behalf. Then you apply the progressive rate structure, and you find that the dividend tax credit reduces the progressivity of the tax structure.

You can look at the dividend tax credit as being two things, the first being an allowance for corporate tax. Mr. Huggett has indicated that in this respect it does not function terribly well. But, if you look at it from the point of view of its being an incentive towards Canadian ownership of Canadian shares, then there is no relationship whatsoever to the underlying tax, and you can accept the fact that if the larger income groups are the people who are the potential investors then the fact that they are getting a better incentive is a good thing—that is, if you look at it from that point of view. But, regarding the dividend tax credit as an attempt to integrate corporate and personal taxes, then it is not a particularly efficient method of doing it.

Senator Everett: But you can look at it as if it is a percentage reduction in taxes, and if you look at it in that way then the tax dividend credit creates a bigger percentage reduction for the small taxpayer than it does for the large taxpayer.

Mr. Goodlet: Yes, if you say he will pay \$30 in tax, and he gets \$20 and pays only \$10 out of the \$30, then it is a $33\frac{1}{3}$ per cent reduction for him.

Senator Everett: We have had two or three submissions, Mr. Chairman, that challenge this assertion in the White Paper that the tax dividend credit is of more benefit to the high taxpayer than to the low taxpayer, and that is why I have brought the matter up. I think the way that they approach it is on the basis of the percentage benefit to the low income earner as opposed to the percentage benefit to the high income earner. I personally do not know which is right.

Mr. Huggett: I think, senator, that we generally accepted the statement contained in the White Paper without trying to pick it apart. It is pretty difficult to measure the benefits, and

say whether they should be in full dollar terms or percentage terms, or what have you.

The Acting Chairman: But you should not accept, in my opinion, the observations in the White Paper unless your conclusions are based upon the assurance that the statements so made have validity.

Mr. Huggett: I believe that the figures in the White Paper certainly do have validity.

Senator Everett: Will you agree with this, that the tax dividend credit being a reduction in tax is a fairer credit to different levels of income than the sort of deduction that would reduce taxable income as, say, the basic exemption does?

Mr. Goodlet: Perhaps I could speak to that for a moment. I think I must come back to the point I made, and ask: What is the purpose of the dividend tax credit? If it is a means of providing relief from corporate tax then it certainly is not effective. Perhaps we could take a very simple example of, let us say, a widow who has \$1,000 in dividend income. She is entitled to the 20 per cent dividend tax credit, but her exemption eliminates that income automatically, and there is no provision whereby she can receive a refund of the \$200 she would have otherwise been entitled to. So, to say that it effectively relieves the low income group is an over-simplification.

Senator Everett: Let us stop there. The point you raise undoubtedly is true, but in the low income group it could be, and tends to be, an offset against corporation tax. It is only in the high income group where it is not.

Mr. Goodlet: I am sorry, senator, but I do not follow that.

Senator Everett: A person who is paying tax at the rate of 20 per cent would have a complete offset.

Mr. Huggett: Yes, they would have an offset, but they would not be entitled to a refund. Perhaps under the integration system low bracket individuals would be entitled to claim back from the Government.

Senator Everett: Do you mean that the tax dividend credit system allows a refund?

Mr. Huggett: Yes, it certainly could, but we thought that the tax credit system *per se* could be very costly in revenue terms, in that

the credit would be available even though the company had not paid any income tax. This could happen quite frequently because of accelerated capital cost allowances, depletion allowances, and other incentives that may be given to corporations from time to time.

Senator Molson: It is true today though, is it not?

Mr. Huggett: Yes, it is true today. When we examined the dividend credit we were thinking in terms of perhaps increasing it inasmuch as the Government with their integration proposals seemed to be prepared to reduce the burden of tax on the corporation and its shareholders. However, an increased dividend credit does become costly where no tax has been paid by the corporation.

We are also concerned that it may open up areas for tax avoidance or minimization when used with the deduction given for capital losses. For example, you might pay out all the surplus of a company, claim the large dividend credit, pay virtually no tax on it, then liquidate the company at a loss because all its funds would have been drawn out and claim a capital loss deduction against other forms of income.

Senator Molson: I do not disagree with anything that has been said. However, I am not clear with respect to the advantage of the 20 per cent to the high in comparison with the low income taxpayer.

If someone earning \$3,000 a year has an exemption of \$100 for dividend credits, this would surely have a much greater impact than the same amount on the higher taxpayer. It seems that this thought is not quite complete.

Mr. R. D. Brown, the Canadian Institute of Chartered Accountants: It is a confusing subject. There are really two issues here. One is whether the credit given to individual shareholders should be automatic, depending on the amount of the dividend or should depend upon the corporate tax paid by the company.

The second point is whether the dividend should be grossed up and taxed on that basis with the tax credit being a simple percentage of the dividends.

With respect to the latter issue, which I believe your question relates to, the real question is how much before tax income does a taxpayer require to be equivalent to the after tax benefit that he receives. In this

sense the existing dividend tax credit does provide a bigger relief for higher income taxpayers because the \$20 tax credit they obtain on a \$100 dividend is worth more to them in terms of equivalence to before tax income than \$20 after tax credit is to a low tax-paying shareholder.

Senator Molson: Worth more in what terms? It is worth more if his rate is 70 per cent, but is his income increased by the same percentage as that of the low taxpayer?

Mr. Goodlet: You can only compare the marginal dollars in this situation. The comparison is illustrated by the exercise of adding \$100 to both the higher and lower bracket taxpayers and comparing the increment in taxes.

However, certainly as a percentage of the overall tax paid by the higher taxpayer it is a relatively lower reduction in tax.

Senator Molson: How does it affect the individual's income? If you had \$2,000 taxable income and obtained \$100 tax credit, are you not receiving a greater benefit than someone in the higher bracket?

Mr. Brown: You are quite correct that it gives a higher percentage reduction in tax to a low bracket than a high bracket taxpayer. For the 40 per cent taxpayer it takes away half of his tax; for the 80 per cent taxpayer it only takes away a quarter of his tax.

The point that you were expressing is that there is another way, perhaps the correct way, to measure it, which is by reference to the amount of the before tax income that a taxpayer must receive in order to obtain the equivalent benefit.

In that sense the existing dividend tax credit is more valuable to a higher bracket taxpayer, because he would have to receive a greater amount in order to get \$20 of after tax income than would a shareholder in a lower bracket. Therefore, the dividend tax credit is worth more to him.

I suggest that it is a matter of semantics in the final analysis. It depends on how one wishes to measure benefit.

The Acting Chairman: To be consistent you would have to eliminate a graduated income tax.

Mr. Brown: Yes, we have always had difficulty here.

Senator Molson: It could perhaps properly be said in this respect that from one point of

view it is a greater benefit to one and from another point of view a greater benefit to the other. However, when you come to the very common practice in business of wage settlements and speak of salary matters in percentage increases, the impact of a sum such as we are discussing from a dividend tax credit would be much greater to the lower rated employees than would that same sum of money to the top executives. Therefore to that extent it is a greater benefit to them.

I am attempting to clarify this and not making a statement.

Mr. Brown: The point is that you should not compare paying a dividend of \$100 to a poor man or a rich man. You should take a man who receives only \$1,000 or \$3,000 of dividend income, which is his only income. The tax credit represents only a modest dollar amount to him. However, if you take a man who receives \$50,000 in dividend income, the advantage of the dividend tax credit to him over his position if he had received \$50,000 of interest income with no dividend tax credit is very substantial.

Senator Molson: I agree with that.

The Acting Chairman: You disagree with the recommendation to which Mr. Hart referred this morning that dividends be a deduction from income.

Mr. Goodlet: That is correct.

The Acting Chairman: You disagree with the present system of dividend tax credits.

Mr. Goodlet: We disagree with the present system of dividend tax credits as a means of measuring individual and corporate taxation.

The Acting Chairman: You have some doubts as to whether the whole philosophy behind integration is sound relating to the issue as to whether the shareholder really pays the tax paid by the corporation.

Mr. Goodlet: Yes.

The Acting Chairman: The consequence of that line of reasoning is that you support an integration system, subject to modification. As a lawyer, I find it difficult to follow that conclusion. Before you answer me, I would like to know whether in coming to that conclusion you considered the experience of the United Kingdom and the abandonment of the integration system.

Mr. Huggett: Yes, Mr. Chairman we have. We have concluded that the United Kingdom abandoned their system because it was essentially a dividend tax credit system, similar to our 20 per cent existing tax credit system, with the one refinement that it was a gross up and credit system, but, as with our dividend credit, the credit was not related to the amount of tax paid by the corporation. This, we understand, gave rise to a fair number of surplus stripping transactions and schemes, whereby refunds were extracted from the treasury, which had not been offset by corporate taxes paid.

The Acting Chairman: Whether one agrees with you or not, you have given me the explanation.

Senator Isnor: Mr. Chairman, at least two of us did not hear the suggestion in regard to dividends as proposed by Mr. Hart.

The Acting Chairman: Mr. Hart's point was that, in view of the dividend tax credit that we now have, dividends paid by a corporation be deemed to be an expense of the corporation before the application of the corporate rate of taxation on profits, and that the present 20 per cent tax credit be eliminated. These gentlemen do not agree with that concept.

Senator Isnor: They do not agree?

The Acting Chairman: Nor do they agree with the present 20 per cent tax credit. But they do agree with a proposed integration system, subject to modifications that appear, more or less, on page 29 of the brief.

Mr. Goodlet: Perhaps I might speak to this. We make the point that any specific percentage selected as a degree of integration will reflect a combination of a desired degree of incentive to obtain Canadian share ownership, and a somewhat arbitrary allowance for that portion of the corporate tax which is considered to be borne by the shareholder. So when we suggest the partial integration proposal we are providing two things. We base this on two premises: (a) the need for an incentive for Canadian ownership of Canadian shares; and (b) some recognition of the fact that part of the corporate tax may have been borne by the shareholders. It is rather a pragmatic conclusion that we reached, the 50 per cent integration proposal.

The Acting Chairman: As a committee we are really sliding into home base on this whole question of integration. How as a committee can we consider the value of integration as proposed in the White Paper until we get more detailed indications to cover objections such as yours, and such as those of others? Would it not be more desirable to say that the proposed integration system has not been thought out in all its details and implications, and until that is done the whole conception of integration be held in abeyance?

I may say that this is the view of a greater number of briefs that have been presented before this committee. Very few briefs that have come from important companies across Canada have supported the concept of integration. I would say you are probably the most important group of people who support the principle of integration, subject to modifications, and that is why I am dealing with this point very seriously. We cannot dismiss your views.

Mr. Goodlet: I think it becomes a question of going back to the original concept of integration, which goes back to the point we have already discussed: does the shareholder bear the corporate tax? I will speak personally at this point, and not as chairman of this group. My conclusion is that this is a matter of faith, not a matter of proof. You either believe the corporate tax is borne by the shareholders or you do not believe it is all borne by the shareholders. There is no conclusive evidence available as to which way it goes.

One must then make one's own assessment of how much incentive one wishes to give towards Canadian ownership of Canadian shares, and how much recognition one wishes to give to the underlying corporate tax, because there is no perfect answer in this area. I repeat, that last comment is a personal observation and not necessarily made as a member of this group. Therefore, you determine your article of faith, and from there decide whether you go for full integration or not.

The Acting Chairman: Articles of faith, as you know, start with conviction, they develop into doubt, and then go into agnosticism.

Mr. Goodlet: We may have reached that point.

The Acting Chairman: You may reach that point if you stay with an article of faith long enough.

Mr. Huggett: May I just add to that? We thought the system of integration was conceptually very attractive, because we see that there is a reduction in the tax burden borne by corporate income. In other words, there is not the same degree of double taxation of corporate earnings—once in the hands of the corporation and then again in the hands of the shareholders. Therefore, when you are offered a tax reduction in a particular area you grab it. As I said earlier, we did not like the dividend tax credit on the grounds that it might be too costly in revenue terms, that people might get credits where there was no corporate tax paid, and we feel that may not be acceptable to the government, particularly if the dividend credit is increased, and it may not be fair. We therefore looked at the system of integration and thought that it was fair, that it was conceptually attractive, and was reducing the burden of tax on corporate income. Now, there are other means of doing this. There is the dividend reduction, which was referred to this morning, deducting dividend from income.

The Acting Chairman: Let me give you another one, which is intriguing some of us and I would like to get your views on it. I agree that there is ground for complaint that dividends may be paid out by corporations when corporate tax has not been paid, where you get a cash flow resulting from tax holidays, depreciation and other factors. What would you think of the retention of the present system of tax credits, provided that—I am not speaking of the amount, whether it be 20 per cent, or increased or decreased, and I am not speaking—which I will come to shortly—whether the corporate rates should be reduced; I am also eliminating the whole business of whether we are really talking common sense when we speak of getting rates down to 50 per cent, which is supposed to be one of the pillars of Samson in this, but which nobody is taking seriously, which is why I said previously that there is a bit of an Alice in Wonderland situation here in thinking of certain aspects of the study of the White Paper—sticking to realities and present tax credits, what would you think of the tax credit system being retained only in respect of dividends paid, where there are surpluses in corporations resulting from corporate taxes paid?

Mr. Huggett: I think certainly that would remove one of the objections that we have to the dividend credit system. Here I am speaking for myself and not for members of the group, because we have not considered it in this context. I think for myself I would find that quite acceptable. Perhaps other members of the group would like to speak on it.

The Acting Chairman: This is an individual thought of mine, which I have developed with one or two of the senators in discussion. As far as I am aware, no such representations have been made before this committee. I am trying to meet a legitimate objection. I am spending a lot of time, honourable senators, on the question of integration, because once we can get that issue settled, many of our problems are solved and we can move on to different problems.

There is merit to the point that a tax credit should not be given to a shareholder when the corporation itself does not pay tax and when there is cash in the treasury and you declare a dividend resulting from circumstances other than having undistributed income from tax paid on hand. We might introduce this modification to the tax credit system. Incidentally, as you know, the Canadian Tax Foundation, which consisted of you gentlemen and the group of tax lawyers to which I belong, were responsible for the whole tax credit system. We felt there was considerable merit to it. There is no reason why what we thought was a religious conviction one day should become a heresy the next. I remember how delighted we were when we made that joint representation years ago and it was accepted by the Government. Admittedly in practice there are other various elements of unfairness. If we introduce this amendment that I suggested...

Senator Cook: Would you please state your amendment.

The Acting Chairman: The amendment would be that a dividend tax credit of 20 per cent given to the recipient shareholder would apply only in cases where the dividends were charged to undistributed income on hand of the corporation in respect of which corporation tax was paid.

What other modifications could be introduced into the present system that would still reduce or eliminate any of the unfairness or anomalies? I am speaking only as a spokesman and as a senator who has, along with honourable senators, listened to over 100

briefs and received letters and which only God knows how many were bitterly assailing the integrated tax system proposed in the White Paper as being ill digested and ill thought out. What would you consider for the present, a further modification of the existing system that would eliminate unfairness, inequities and injustices?

Mr. W. K. McIntyre, The Canadian Institute of Chartered Accountants: Your proposal is essentially the same as the integration system in its effect, except that it is simpler in that the shareholders do not have to be confused by this grossing up of a dividend. If they get a \$100 dividend let us say they are entitled to a credit of \$25.

Senator Cook: Now they are entitled to 10 per cent depletion or 20 per cent depletion and they get a slip of paper from the company saying so. When a dividend of \$100 cash is paid to a shareholder the company would advise him that he should report \$150 for tax purposes, and that he would be entitled to claim a credit of \$50 against his tax payable. There is not that much difference.

The Acting Chairman: Would you prefer living with the wife you know rather than the one you do not know if you could modify her attitude and put some conditions on her?

Mr. Goodlet: Could I comment on your suggestion? Your proposal is extremely close to the one we are suggesting except for the absence of the gross-up aspect.

The Acting Chairman: And the elimination of privately held companies and publicly held companies.

Mr. Goodlet: We have suggested essentially the same thing with the difference that we believe the gross-up adds an element of equity or keeps progressivity. I think one can live with it. It would be simpler to administer from the taxpayer's point of view because he would understand it better. However, I believe after a period of time if the shareholder receives slips from corporations saying that he should include an income of \$150, and that he is to take a credit for \$50 rather than taking a 20 per cent credit, after a short period of time he would get accustomed to that too.

The Acting Chairman: The reason I am suggesting that is that you are the real petitioners who have to deal with the implementation of this White Paper.

I now go back to something which has bothered all honourable senators. At this stage of the game no one seems to take it too seriously. I refer to the failure to get the consent of the provinces to this revolutionary system. I refer again to Mr. Bryce who was the first witness before this committee. I quote paragraph 1.15 on page 7 of the White Paper which says:

A final important goal for tax reform in Canada must be its appeal to provincial governments and legislatures as a system they too can use. In our federal structure of government we are striving for harmony in federal and provincial tax policies and practices. Much has been accomplished in this respect in the past generation. The proposals in this paper have been designed to permit that progress to continue.

That sounds rather interesting, doesn't it, in the light of what has happened since the White Paper was published. We go on to page 80 of the White Paper, sections 7.1 to 7.5, inclusive. This is an indication of how to get the consent of the provinces to eliminate what is quoted in 7.5:

The "tax jungle" that had quickly developed as a result of unco-ordinated policies...

of the provinces, and so forth. In the light of the statements which have been made by premiers, ministers of finance and others in important provinces of our country, do you not think, as a tax petitioner in this country, that the desirable approach at this stage would be a piece-by-piece treatment of necessary tax reforms until we get a consensus with the provinces rather than introduction of the completely revised system of taxation as contemplated by the White Paper?

Senator Cook: How much established jurisprudence would be thrown out the window by taking an entirely new system and going into the jungle without any chart or compass at all? We have had a great many years with the present Income Tax Act. Do we just throw out a whole lot of things and start a new one which no one will be able to understand for a long time to come?

Mr. Goodlet: I will answer your question first, Mr. Chairman. If the provinces do not go along with this system and impose one of their own, unquestionably we will return to the tax jungle which I think tax petitioners

were familiar with in Canada a number of years back. It will result in more inequities...

The Acting Chairman: It is your statement which I wanted the honourable senators to hear.

Mr. Goodlet: I said if the provinces...

The Acting Chairman: That is what I said, if the provinces do not go along with the proposed new system, do you think that it can be properly implemented without aggravating the tax jungle set-up which we have at the present time?

Mr. Goodlet: No, sir, I think that is self-evident. We have the provinces already relying on the federal base for income for determining their collections. If they adopt a different income base than adopted by the federal Government, inevitably we are going to go back to different tax returns for different provinces and in the end result we would finish up with a large number of tax returns. They would all be prepared on a different basis.

Senator Burchill: Mr. Chairman, I just want to say that, in all our discussion here as to the best method, I feel that we must underline the importance of incentive to the Canadian to invest in Canadian corporations. I do not think we should overlook that, in deciding what we have to do, because that is terribly important, judging from certain people that I move among and hear from and all that. To destroy that would be wrong.

The Acting Chairman: Honourable senators, before we leave this question of integration, I would like you to agree with me, because we have your views on page 29. I would like you to consider this, because I think you are the most competent ones in the country to consider it. On the assumption of the retention of the present system of tax credits, what suggestions could you make, listing corporate rate, tax credits, no integration, and so on, what suggestions could you make other than the ones that I have suggested, that would approximate your tentative conclusions as reflected in page 29? Would you think about that and could the Chairman in due course hear from you about that, by letter addressed to our chairman, Senator Salter A. Hayden, within a reasonable period, in terms of two to three weeks, or even before then?

Mr. Goodlet: Yes, we will do it as quickly as we can.

Senator Carter: Mr. Chairman, I had to be out of the room and there was some talk after I came in about shareholders getting \$100 dividends, making a return for \$150, and getting \$50 back.

Would that be permissible under the law? That would not be a statement of fact, if he got only \$100 income and made the return for \$150. That would not be a statement of fact, it would not be a true statement.

The Acting Chairman: No. We were dealing, Senator Carter, with the proposed system under integration, where, because you are going to get a credit against your taxable income of the corporate tax paid, you start off by your proportion of the corporate tax deemed to have been paid on your behalf as part of your income and then you get the offsetting credit therefrom.

Senator Carter: That would be "deemed", would it not?

The Acting Chairman: Yes, it is deemed, obviously, because it is not a realized income. The whole concept is that under the integration system the corporation is deemed to be the agent of the shareholders and the tax paid by the corporation is deemed to have been paid on behalf of the shareholders. Then you offset it by the tax that the corporation has paid, presumably on your behalf. It is a very involved system, that is eliciting considerable objection on behalf of so many taxpayers, which is reflected in the hearings that we have had here.

Senator Cook: May I ask just one general question. On the one hand, as between the dividend credit system, either adjusted or left as it is, and on the other hand the integration system, would there be very many people affected if we had the integration system as proposed and would there be very many gross inequities corrected by switching from the system we know, perhaps adjusted, to a completely new system.

Mr. Hart: Everyone who owns shares, sir, would be obviously affected some way or another. Those with substantial shareholdings and substantial dividend income would be affected quite substantially. As to the correction of inequities, I think we must go back again, though I regret to do it, to the fundamental purpose of what the dividend tax credit is for. If it is for relief of corporate taxes, how can you justify a credit to a large corporation, paying very substantial divi-

dends, which has not paid taxes? This is the fundamental problem.

The Acting Chairman: That is the one I have been trying to deal with in the manner I have indicated to you.

Mr. Hart: Yes, you would put a check on, to prevent that happening.

The Acting Chairman: Yes, or, if it does happen, then the recipient shareholder would not get his tax credit.

Senator Cook: May I rephrase the question? If you remove the "if", as suggested by the chairman, then is the change from the devil you know to the devil you do not know going to correct any serious inequities in this tax system?

The Acting Chairman: Would you like to answer that?

Mr. C. McLaughlin, The Canadian Institute of Chartered Accountants: I would like to say—speaking only for myself, because we have not had a chance to discuss this together...

The Acting Chairman: I know. It is difficult to get a consensus on such an important matter.

Mr. McLaughlin: Speaking for myself, I find the proposal attractive. However, off-hand, and I have not given the matter too much thought, I would suggest the following amendment—that wherever a taxpayer has received dividends and he is not in a taxable position, or where his taxes, say, are below the 20 per cent rate of the dividend credit, he be entitled to a refund.

The Acting Chairman: Very well. That is the very reason why I am suggesting that, after you think this out a little more, within the framework of the present system you may come across one or two other thoughts. As Senator Cook has implied, we might, without a revolutionary change in the system, get the result that we want. After all, if we do not reach perfection, if we get close to heaven, it is better than being down on earth or in hell. For instance, take one of the main objections to the integration system. I do not know whether you developed it in your brief. If you did, I overlooked it, although I read it carefully last night. One of the main objections a good many people seem to have to the integration system is the pressure on corporations

to declare dividends out and the inflationary factors that flow therefrom, and we are very much concerned about it.

Senator Cook: They may issue bonus shares, for a two and a half year period.

The Acting Chairman: Yes. In other words, if the individual shareholder says "the corporation taxes have been paid on my behalf", then he is the boss man and the pressure imperceptibly goes down to the board room from the point of view of the declaration of the dividend out.

Senator Cook: This would be introducing artificial restrictions and would be an incentive on the management of the company to disburse the capital of the company that should be kept.

The Acting Chairman: Yes, that is right. We have raised this very important point, and it has been raised before. Should a tax structured system introduce a concept that interferes with the normal subject matter of the powers of directors appointed by shareholders to declare dividends, because of the extraordinary difference in the demand made across country by different types of corporations? I apologize for speaking with such great intensity on this point, but we are all trying to do our duty here, to come up with something for the benefit of the country. That is why I am attempting to retain the present system. I am speaking as an individual. I am not chairman of this committee, I am only acting *pro tem* and I have no authority greater than that of any other senator—indeed, less, because of my short tenure here. But I am trying to retain the present system and produce as closely as possible as we can the equities that we are groping for.

Mr. Huggett: Mr. Chairman, if I may just reply to your question concerning forced distribution. It has been suggested that pressure would be put on corporations to pay out their earnings, with perhaps ill results in so far as the corporation is concerned. I do not believe that is really true. Under the White Paper proposals, corporations will be able to pay stock dividends and thus give their shareholders the credit for the corporate tax and yet the companies will still retain the cash. I think we agree that, if companies continually have to issue dividends in stock, it will be cumbersome and complicated. Those who like to have portfolios in the even hundreds or the even thousands will find them being mucked

up with odd shares. But to the extent that you eliminate or bring closer together the position of the corporation and the shareholder, that is to reduce the burden of corporate and personal tax on business income, then you are going to build up a pressure by shareholders to have distributions. And if, for example, you go to a 25 per cent dividend credit which is refundable, then shareholders in a bracket that is less than 25 per cent will very definitely want distributions from the company, because they can then get a refund from the Government. So I think that that pressure is there and the only way to relieve the pressure is not to give any credit for corporate tax.

Senator Cook: But that pressure exists now.

Mr. Huggett: That is right, but it will be, perhaps, more extensive as the double tax burden is reduced.

Senator Cook: It will be twice as extensive if they lose that 2½ years.

Mr. Brown: Yet, I think the point under the White Paper proposals is that the 2½ year rule would induce corporations, I think, to distribute a slightly larger share of their income. We recommend that the 2½ year rule be abolished because we do not think it serves any effective purpose. And to the extent that any safeguards are necessary against tax manipulation, these could be provided by other means. We do not look to the type of modified proposals put forward in our brief or your suggestion, senator, to lead to any dramatic increase in dividends. At least, I don't think so.

The Acting Chairman: All right. Then, while we are in this area, and we have discussed this previously and it is relevant—you remember many years ago under the old Act, we had section 13 of that Act which gave a ministerial discretion with respect to forced distributions of dividends or deemed to be distribution of dividends. We all know the background which led to its repeal. What do you think of the reintroduction of the right of the Minister to cause distribution when the Minister establishes that the retention is not required for legitimate corporate purposes or for corporate purposes generally.

Mr. Goodlet: I think, Mr. Chairman, that this is a technique which has been used in a number of tax systems throughout the world.

I believe that Australia, for example, in the case of certain taxes on corporations, has a formula that says that any excess retention over this formula is automatically deemed distributed. In the United States they have a somewhat looser arrangement whereby they have excessive retentions legislation, but I understand from my discussions with some of my American colleagues that it is not terribly effective down there. I wonder if any of our other members have information on this.

The Acting Chairman: How would the Institute feel about the reintroduction of section 13?

Mr. Huggett: If I may reply to this, Mr. Chairman, and speak personally here because we have not considered this at all, I would be very much against such a provision. I think that the board of directors of a company is in a much better position than the Minister of Finance to know whether dividends should be paid out or not.

The Acting Chairman: Do you think that applicable to holding companies as distinct from commercial, manufacturing and operating companies?

Mr. Huggett: Well, if there was some problem there, I would rather impose an additional tax on the holding company than have a forced distribution.

The Acting Chairman: I see, but you do agree that there is a problem involved there with undesirable retention?

Mr. Brown: In our brief we have recognized this and that our proposals would create a problem with respect to holding companies and other corporations retaining capital. So, in our brief we did suggest that either such tax as you propose should be introduced—that is a tax on reasonable accumulations of surplus—or that the rules with respect to personal corporations should be strengthened.

The Acting Chairman: Would you be good enough to identify that right now because I think that is important.

Mr. Goodlet: It is D.47 on page 35.

The Acting Chairman: Would you be good enough to read this into the record, please, if it is not too long.

Mr. Goodlet:

Our recommendations with respect to the tax treatment of all corporations will,

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because full credit will not be given for the corporate tax, encourage individuals to transfer their investment portfolios to corporations which do not elect the partnership option. This will have the effect of postponing the additional tax that should be paid and will therefore require legislation similar to that presently applicable to personal corporations to offset the tax deferral that would otherwise be available. This could be accomplished by modifying and improving the existing personal corporation legislation or by imposing a special tax upon the income of such corporations derived from dividends from Canadian corporations which were not distributed to shareholders.

We therefore recommend that:

(a) special capital gain distribution rules be established for all corporations so that such gains can be distributed without further tax to the shareholder;

(b) special rules be prescribed for corporations in the personal corporation category including, if necessary, a tax on net dividends from Canadian corporations;

(c) if our proposals concerning the tax treatment of corporations are not accepted, then we recommend that the whole area of intercorporate dividend flows be reconsidered and modified so that the anomalies we have noted are removed.

The Acting Chairman: As a start, at least, we could retain the exemption in respect of dividends from one Canadian company to another company, but in respect of holding companies—because at least there Government can express a view as distinct from the running of businesses and the like—a special tax should be imposed, if certain factors are present. Let us leave it at that. But just not to let this huge accumulation of exempt income flowing from one Canadian company to another bring about an imbalance in the concentration of wealth, which I think we are all familiar with and which is anti-social in its consequences.

Mr. Goodlet: I think we are all agreed that there would have to be some form of legislation dealing with holding companies equivalent to the personal corporations.

Senator Aseltine: Mr. Chairman, do I understand that if these proposals are adopted that personal corporations would be done away with altogether? There would only be

closely-held corporations and the others. I am interested in certain personal corporations that are merely investment corporations with one or two shareholders. Now if they are going to be done away with and we elect to be taxed as partnerships, we might as well wind up the companies and be done with them, because we do not know what legislation might be brought in suddenly to affect these personal corporations. What have you to say about that?

Mr. Huggett: That is correct, senator, but under the White Paper proposals personal corporations would be treated as closely-held companies and there would be no necessity for the distinction. Under our proposals whereby credit is only given for half of the corporate tax, it would be necessary to retain the personal corporation provisions in order that the other half of the tax be collected and not postpone it indefinitely.

Senator Aseltine: What we do presently is at the end of the taxation year we just make up a balance sheet and show what the profits are and we divide them according to the shareholders. That will continue to be the law if you elect and if these provisions become law.

Mr. Huggett: We are suggesting that that status continue, or alternatively that instead of the individual paying tax on the corporation income, the corporation itself pay tax partially on behalf of the individual.

Senator Aseltine: They would not like that.

Mr. Huggett: The other alternative, of course, is the partnership option, which has virtually the same effect as the existing personal corporation provisions, so those who wanted that type of treatment would take the partnership option.

Senator Aseltine: If the profits were taxed in the hands of the corporation, the tax would be 50 per cent.

Mr. Huggett: Yes, but our proposal is that in so far as dividends are concerned they pass from one corporation to another virtually tax-free. If an additional tax were to be imposed at that time, it would be in the order of 25 per cent, and that would bring the tax rate on those dividends up to the same amount as would have been paid if the dividends had been received by an individual directly.

I would like to make one correction. I said a tax of 26 per cent. It need only be 16 2/3 per cent to bring the burden of tax up to the 50 per cent rate.

The Acting Chairman: I think we have sort of flayed this integration point, and I think we may have come up with something that could be constructive, particularly after you give consideration to my request. At least, in so far as this committee is concerned, it could be a solution to something that has been bothering us a great deal.

We want the benefit of your thinking on small businesses. I am deferring consideration of capital gains until the afternoon, because we want the benefit of the attendance of some of our senators who are on the Finance Committee.

Here again, you have not sat in on a good many of our hearings, but I think it is fair to say that we, or at least a good many of us, are coming around to the point of view that we see no value in corporations at large getting the benefit of the lower income tax rate for the lower amount of income. On the other hand, we see the absolute necessity of protecting small businesses. Some of us have come to tentative conclusions that we see no merit in defining small businesses in relationship to capital assets involving accelerated depreciation or subsidies. We are not particularly attracted by the principle of tax being applicable on a deferral basis if, as and when the profits are declared out of dividends, even. Some of us are coming around to the point of view of simply giving small businesses the benefit of the lower rate, but the problem is how to define a small business.

With your vast experience across the whole economy, would you identify "small business" as related to sales, capital and surplus, earnings or any other factors?

Mr. Goodlet: I would defer to Mr. Huggett on that question, because that is an area with which he is more familiar.

Mr. Huggett: Mr. Chairman, I am afraid that we have not been able ourselves to come up with a definition of "small business". As you recognize, there are many problems, I suppose the most important of which is that if you do define it in terms of assets or sales, then once the business reaches that level they will hive off other operations and start another small business. I think we would be opposed to defining it in terms of earnings, because the earnings can always be adjusted

by salaries to the major shareholders, so when a corporation was getting to the point where it would fall outside the definition of "small business" placed on earnings, they would simply increase the salaries of shareholders.

The Acting Chairman: That has been said before, but there is sufficient provision in our law to cover that. Sections 11 and 12 of our act provide sufficiently that a deduction could only be related to that which is justified by proper business principles.

Mr. Huggett: With respect, Mr. Chairman, take an individual who is in business for himself, if he earns \$150,000 as a sole proprietor and all the profits are due to his efforts, then I think that man's salary, in a corporation, may be justified at \$150,000. This is a difficult area. There are provisions in the act to disallow unreasonable expenses, but I submit that in the case of a sole shareholder of a business, whatever salary he takes is not unreasonable. I think that is a very difficult area.

The Acting Chairman: Will you continue? I interrupted you.

First of all, would you agree that the lower rate should only apply to small businesses and that the benefit of the lower rate should not be given to businesses at large?

Mr. Huggett: Yes, very definitely, we do agree, that if there is to be a low rate it should be confined to small businesses.

Senator Cook: Accepting that statement—and we all agree with it—could not it be cured by just adding half a per cent to the rate after a certain figure—in other words, staggering the rate upward instead of interfering with the present system?

Mr. Huggett: You mean, scaling the low rate up, dependent upon the...

Senator Cook: No. Take a round figure for the purposes of illustration. We say that no business earning less than \$100,000 is entitled to the 21 per cent, could it not be cured by just making the effective rate for business over \$100,000 51 per cent, then 50.5 per cent or 50 per cent, and cure it that way?

Mr. Huggett: That, of course, is introducing a system of progressive corporate income tax rates, and, again, you end up with every corporation having to split itself into separate companies.

Senator Cook: Not if you make the rate high enough. The present way, you say we do not believe it should be made available in respect of earnings not retained in the business. You have two definitions: the definition of "small business"; and the definition of "small growing business". If we switch the system at all, we want a greater volume of definitions before you know where you are.

Mr. Huggett: This is certainly a very difficult area and, as I said, the Carter Royal Commission report had a definition of "small business". Their criteria were: less than \$1 million of assets and sales, gross revenues of less than \$10 million. That might be an acceptable definition, but it is a question of judgment.

The Acting Chairman: At least, we have the support of you gentlemen that we would be justified in suggesting that a special rate be applicable to small businesses, without that rate being necessarily available for all corporations.

Mr. Huggett: Well, Mr. Chairman, our brief says that we support the elimination the low rate provided that incentives or assistance are offered to the small business category, and we have listed four alternatives for consideration.

The Acting Chairman: On what page is that?

Mr. Huggett: At page 30, in paragraph D.26. These alternatives involve accelerated capital cost allowances—perhaps modifying the capital cost allowance system to allow every small business to write off the first \$15,000 of assets acquired, or perhaps instituting a special allowance or deduction from taxable income related to increases in working capital and fixed assets. We have also suggested that perhaps the additional corporate tax could be postponed for a period of perhaps ten years. All of these would, of course, involve the necessity to retain the associated corporation provisions in order to prevent...

The Acting Chairman: Yes, of course, but under (d) you have a deferral of tax liability rather than a real incentive to small business.

Mr. Huggett: All of these, Mr. Chairman, are, in effect, deferrals of tax because if you have a too rapid write-off on fixed assets then you do not get any deductions in subsequent years.

The Acting Chairman: I know, but sometimes accelerated capital cost allowances are hardly deferrals because sometimes they do not last that long. We do not have to go into that now. We have your references.

Senator Isnor: Mr. Chairman, before you close this morning's session may I inquire from Mr. Goodlet why the Maritimes are not represented?

Mr. Goodlet: We have a representative from the Maritimes on our committee, and he contributed greatly towards the brief you have in front of you. In the interests of economy we drew our representatives for this visit from the centre of Canada. It is strictly because of economy and time that we drew our small group here from central Canada, but if you refer to the front page of our brief you will see that we are represented from Newfoundland to British Columbia.

Senator Isnor: So you say in your brief, but I was wondering why there was no representative from the Maritimes present today.

The Acting Chairman: We are taking so much time with these gentlemen because they are experienced in these matters, and can be very helpful to us.

Gentlemen, we will resume in Room 356-S, which affords better quarters, at 2.15 this afternoon. The members of the committee have to attend the Senate at 2 o'clock, so we will continue our hearing at 2.15.

The committee adjourned until 2.15 p.m.

—Upon resuming at 2.15 p.m.

The Acting Chairman: Honourable senators, I will call the meeting to order. I intend to recapitulate the discussions that took place this morning before we proceed this afternoon because some of the honourable senators were not present.

We covered at some length the question of the subject matter of integration. We have asked the Canadian Institute of Chartered Accountants to give us some suggestions regarding the possibility of the retention of the present tax credit system without the necessity of introducing the complicated method of integration.

Secondly, we dealt with the issue of small businesses. Among other things we have asked the chartered accountants to express their views thereon, which they have done under the following headings: (1) they are in concurrence with the view generally

expressed that small businesses are entitled to special consideration and that it is not necessarily desirable nor worthwhile that companies generally get the benefit of the low tax rate up to the first \$35,000 worth of income. As an association, however, it is not prepared to give us the benefit of any thinking as to the definition of a small business. As a matter of fact, their views are somewhat different from those generally dealt with, because they cover capital assets, special depreciation privileges and the like, and even include the suggestion that the benefits to small businesses do not involve an outright concession of low tax rates but rather a deferred concession of the lower rate. However, the application of the ordinary corporate rate when the profits in respect of which the lower tax rate is applicable is worked out by way of distribution amongst the shareholders. I think there is even a 10-year provision in connection therewith.

Senator Molson: With regard to the last point, in the event that there is no payout then the tax does not apply.

The Acting Chairman: The tax benefit heretofore given is lost provided that the payout does not take place within a period of ten years from the time of the tax concession.

Can you identify the exact page that we had this morning, please?

Mr. Huggett: Page 30, at the very bottom, paragraph D.26, subparagraph (d), which carries over on to page 31.

The Acting Chairman: Would honourable senators like further discussion on this subject matter, or is it covered by the recapitulation and the reference?

May we go on to other headings now? Honourable senators, I suggest that we deal with an item which I am glad to see this Institution has put practically at the top for study. That is found on the first page of its submission. The first paragraph is headed "Summary of Conclusions", which we need not deal with. We are now at Chapter A—General. Here we are dealing with the critical subject matter of reduction of taxes to lower income groups and the necessity for a widened tax base, and so on.

That will cover the subject that we have discussed as to whether the first 750,000 taxpayers should be eliminated from the tax rolls. Also as to whether we need give

increased exemption of \$1,400 to non-married people and \$2,800 to married, which would involve a cost of about \$1,200 million. It covers the whole question of the shifting of the burden of taxation resulting from that loss to the median bracket income group. This is the point on which we have had so many representations that it would be most unwise, some have indicated disastrous, if we attempt to recover the \$1,200 million lost in the process of exemptions by shifting it to people on whom we rely in terms of incentive for the development of our country.

Gentlemen, will you take over on this very important aspect of the White Paper?

Mr. Goodlet: I would like to refer this particular question to Mr. Brown, the Vice Chairman, who has dealt with the question of individuals at length.

Mr. Brown: We do feel that the people at the bottom of the income tax bracket should be relieved of some of the burden of taxation which they now bear. Therefore we support the recommendation of the White Paper that the present exemptions be increased to \$1,400.

We recognize that this involves a very major cost in terms of foregone revenue. However, the cost is perhaps misleadingly put at \$1 billion. Only a small portion of this foregone revenue will in fact accrue to the people at the very bottom of the rate bracket. In fact, the loss of \$1 billion through the increase in personal exemption and the revenue gain of \$1,200 million because of the change in the rate structure offset each other for many Canadians.

The Acting Chairman: Will you stop there, Mr. Brown.

Mr. Brown: Certainly.

The Acting Chairman: As of the moment this committee is seized of the conclusion that if we eliminate the 750,000 lower bracket people referred to in the White Paper the loss to the Treasury will be about \$35 million. There seems to be a general consensus in that respect.

I always say I am expressing a personal opinion, but when you increase the exemptions beyond that there is a loss of approximately \$1,200 million.

Mr. Brown: That is right.

The Acting Chairman: Are you in favour of those exemptions involving that loss being granted?

Mr. Brown: Yes we are, because in effect we think that the part of the proposal to which I believe you take exception, the increase in tax rates for middle income groups, can be avoided through a reduction in the rate schedule.

We feel that within the revenue estimates of the White Paper itself there is sufficient leeway to provide for very substantial reductions in the proposed rates for middle income taxpayers and also relief for lower bracket taxpayers.

The Acting Chairman: Is that because of the \$600 million increase even admitted by the White Paper?

Mr. Brown: This is correct. We feel very strongly in support of the position taken by many people before your committee that the rate structure proposed in the White Paper is unfortunate and would have an adverse effect on incentive and growth. I do not think there is any direct conflict between the recommendation to increase the exemptions to \$1,400 and the desire to provide some measure of relief for middle income taxpayers. Even the revenue constraints as set out in the White Paper and the revenue considerations may be more favourable than that.

The Acting Chairman: Will you develop that. In other words, you feel that because of increased taxation which should not necessarily follow from the reform concept, even though the exemptions are given—\$1,400 and \$2,800—there is no reason it should be shifted to the so-called middle income incentive people?

Mr. Brown: I want to make it clear. If you increase the personal tax exemptions to \$1,400 you will likely have to increase the tax rates on middle income Canadians, but only enough in effect to sop up the benefits that they get from the increased personal exemptions. There is no need to increase the taxes payable by middle income Canadians. That is the point we wish to bring across.

The Acting Chairman: Why give the incentive to start with and why lower the rate to offset it?

Mr. Brown: It becomes a question of mechanics. Actually, you can work it out either way to give exactly the tax burden either through a personal increase restriction on the rate structure or something approaching the present rate structure and taking people off the bottom of the tax roll.

The Acting Chairman: Are you against the White Paper thrust of increasing the burden against people?

Mr. Brown: Yes, we are. We pointed out that we are considering this rate increase unnecessary and feel that it will have an adverse effect. It will widen the already existing gap between Canadian and United States taxes in this regard and we feel that it is unnecessary. We think the issue of a tax reform should be separated from the issue of tax increase. If we have to have increases in taxes, then we feel this should be a separate issue debated at the time the cause for increase becomes apparent.

Senator Molson: Mr. Chairman, I would like to ask Mr. Brown how he reconciles this with what he was saying this morning about the impact of dividend tax credits. If you raise the exemption then you are giving a greater benefit to the top income tax brackets. That is exactly what you said this morning, and we did not approve of it.

Mr. Brown: Our acceptance of the increase in personal exemptions is predicated on some changes in the rate structure which would prevent top bracket taxpayers from obtaining any net benefit from the increase in personal exemptions.

Senator Molson: What sort of general scope are we alluding to in this respect?

Mr. Brown: I am afraid that we cannot be precise because we do not have our own computer, and these calculations are enormously complex. The difficulties which the federal Government got into in the Province of Ontario shows you how complex they are. We feel that a modest increase in tax rates for upper bracket taxpayers, combined with an increase in personal exemptions, could provide lower taxes for lower income Canadians, no increase in taxes for middle income Canadians and the relatively small loss of revenue being made up from other tax sources, such as a tax on capital gains, and so forth.

Senator Molson: Have we dealt with capital gains yet?

The Acting Chairman: Not yet.

Senator Carter: I think Mr. Brown referred to the differences between income taxes paid in Canada and various taxes paid in the United States. We have had many witnesses

who have stressed that point and say that it would be difficult to get managerial experience to come here and remain. In the comparisons we have had or at least the ones I have seen it has been focused only on the income and it has not, to my knowledge, taken into account the medicare and the extra fringe benefits we have in Canada which do not apply in the United States. Has any comparison been made in taking all of these factors into consideration?

Mr. Brown: Not to the best of my knowledge. It is very difficult to do that, senator. If you are talking about people and comparing their position in different countries I think if they start off by comparing the personal tax burden they would suffer in each country. That is an obvious comparison which is objective, and you can understand the results of your comparison. Any such comparison will show that most middle income Canadians pay substantially more taxes than they would in the United States. The difference will depend not only on the income level, but the individual situation of the taxpayer. After they have made that comparison they then look at such things as medicare, education, hospitals, compulsory service in the army, and many of these differ in our two countries. It is very difficult to convert all of these into some sort of figure.

I might point out that most middle income Canadians you would be making the comparison for would be covered, if they were residents in the United States, under private hospital schemes paid for by their employers. For them there would be no advantage in the Canadian medicare system. There is no net advantage to this type of person.

Senator Hays: On this very subject, in your experiences as a chartered accountant, what is the percentage of people earning between \$12,000 and \$20,000 who have heretofore participated in capital gains on the sale of houses, stocks and that sort of thing, which is also a sort of fringe benefit? Do you have any figures?

Mr. Brown: No, we have no figures. The only available statistics I have, senator, in this area were derived from United States statistics based on their experience. These show that in the year of income about \$10,000 in capital gains begins to be an important component of income. Even from my recollection, it would only average a few hundred dollars a year. It would become much more

important, let us say, above \$18,000 or \$20,000 a year. These are average figures. Some people in this income bracket realize very large gains in a particular year, as for example when they exercised stock option or sold a house and moved to a different locality.

The Acting Chairman: If you had to choose between increased exemptions and the proposed increased taxation to the so-called middle income brackets referred to in the White Paper, which would you prefer? Let me put it differently. On the assumption that the rates would not be reduced in the middle income brackets do you think the exemptions, by way of increase, should be granted? I will ask the question another way. Do you see any particular public opinion pressure or equity necessity for increasing the exemptions up to \$1,400 in one case and \$2,800 in another case at a loss to the treasury of \$1.2 billion and, in the process, creating a problem?

Mr. Brown: I am not in a position to judge public pressure. As far as our institute is concerned we are very much in favour of lowering the tax burden on people making less than \$1,400 and \$2,800 and offering some relief to people who make just above that level. We feel with inflation and the difficulties that have taken place in Canada over the last few years, these people do deserve some relief, even if it will result in higher taxes for other Canadians. I do not think the increase need be anything like that calculated in the White Paper.

The Acting Chairman: Do you not think the answer to that is social contribution or negative income tax concepts rather than destroying incentives in the middle brackets or the development of this country?

Mr. Brown: That may be right.

The Acting Chairman: That is the point I want to get from you gentlemen, who are close to life in filing returns for people. You have to make alternative choices and to some of us it seems to be rather strange that by a stroke of the pen you create a situation of deficit problem to the extent of \$1.2 billion and you shift the burden to incentive people on whom we rely and who are the decent hard core of this country. I do not mean that there are not other decent ones, but these are the family people who are rearing children and trying to educate them and persons who will be in executive positions, studying scien-

tific development, technology and many other things.

Mr. Brown: We would like to make it clear that in our view the personal exemptions can be increased to \$1,400 and \$2,800 without imposing taxes on the middle income bracket. We see no conflict between the desire to increase exemptions and the desire to keep the tax rates realistic.

The Acting Chairman: Where would you get the \$1.2 billion?

Mr. Brown: The cost in the increase in the personal exemptions can be largely offset through increases in tax rates of other income levels which will not increase the net tax burden at those levels.

The Acting Chairman: Let us go to town. Where do you get the \$1.2 billion? Whichever group goes on a graduated income scale today should be subjected to higher rates of taxation in order to absorb that.

Mr. Brown: I think the \$1.2 billion is a bit of a misnomer. It offers relief, not only to low income taxpayers, but all the way up the line. You simply allow the benefits to remain at the lower income bracket. The benefit which is given to everyone else, you simply tax away by adjustments to the rate structure. There are all sorts of different estimates which can be made of it. That is the only net amount you have to raise from other sources, it is not a figure of a billion dollars.

The Acting Chairman: Would it not be much simpler to reduce rates of taxation in lower brackets other than those who are proposed to be taken off the rolls completely, rather than increase the exemptions and then increase the tax rates to offset the exemptions?

Mr. Brown: That may well be. Essentially, I think the point that you are making, is one that can be related to a system of tax credits rather than exemptions, whereby you knock the people at the bottom of the income tax bracket off the tax rolls altogether, leading the position of those above that substantially unchanged. In our brief, on page 5, the second page 5, paragraph B.3 we suggest such a system of credits might well be a more flexible answer. We appreciate that, every time you change the exemption, you also have to change the personal rates structure.

Our point is that, while we are prepared to exempt the personal exemptions for the pur-

pose the Government has put them in, to provide relief for lower income Canadians, we feel that in the long run the tax credit system may be more appropriate. Under this system, you apply the tax rate to a person's entire taxable income and then reduce the resultant tax liability by a set amount and in effect this allows you to take off the roll completely those at the very bottom of the rate structure without affecting the tax liability of all the people above it. We feel that, in the long run, this is a more flexible approach. We do not have the mechanics to calculate all the rates and so on which will be necessary under this system to raise the same amount of money and therefore we have not put in any particular rate suggestions.

Senator Hays: What does the average chartered accountant earn? What bracket does he fit into?

Senator Beaubien: We want to soak that bracket.

The Acting Chairman: Is that a privileged question?

Mr. Goodlet: I think we could quote from taxation statistics which show the average chartered accountant with a range of something from \$14,000 to \$16,000.

Senator Molson: Well behind the lawyers, is that not correct?

Mr. Goodlet: Yes, sir.

Senator Hays: Do we have these figures available with this committee—it has been received so many times, but I do not have them in my head—as to the amount of taxpayers who earn over \$25,000 in Canada and the tax load? You are familiar with those figures?

Mr. Brown: Yes, I am, but I cannot quote them from memory.

Senator Hays: It is a very small group, something like 48,000?

Mr. Huggett: Those figures are in the records of this committee. That is where we got them.

The Acting Chairman: On the question of income generally, I think we are all reconciled to the fact that income is in reverse relation to aptitude. You know that.

Senator Everett: Some people are more apt than others.

Senator Carter: For people who are going to be taken off the tax roll, if you substitute tax credits for exemptions, would it make much difference in the administration? I am thinking about deduction at source. I presume that these fellows are already off the tax roll. If they are earning money, there will be some deductions which they will get refunded when they are passing in their income tax returns.

Mr. Brown: Under the White Paper proposals or anything else they will remain subject to some sort of deduction and record keeping, because although they will be exempt from tax they will be subject to Canada Pension Plan contributions. So they will remain within the ambit of the tax system even though they are not subject to tax. I think that a tax credit system could be handled by way of payroll deductions just as readily as an exemption system. One could build it into tables which are precalculated and all one has to do is take the income on the table and take the necessary amount off.

The Acting Chairman: Would you be too upset if the general approach for the present were on a cautious basis, if we eliminate 750,000 taxpayers, cause a loss to the Treasury of \$35 million, do not increase the exemptions and do not shake the middle income brackets in any way by increased rates?

Mr. Brown: I do not think that we would be opposed to this. In our view, I think we would urge that some additional relief should be given to a taxpayer who makes just over \$1400 or \$2800 a year, that these people should get some relief, even at the cost of some foregone revenue to the Treasury which we anticipate.

Mr. Goodlet: If I may add, one of the problems there is this. You cannot just take the 750,000 off, because then you have to put a notch provision in to cover those who come just above that, so your cost may be somewhat higher than the \$35 million.

The Acting Chairman: Higher than the \$35 million, that is right. Are there any other questions under this heading?

Senator Everett: That is section A?

The Acting Chairman: Yes and it started off on the first page of the summary of conclusions, chapter A general, which I thought was quite important to deal with.

May I, with your approval, go over to chapter C, capital gains?

Senator Everett: Was it your intention to come back to chapter B?

The Acting Chairman: We will come back to that later. I would like to move over to chapter C, on the capital gains section, please, page 14.

Here again, to start the ball rolling, we have had a wide gamut of opinion on the subject matter (a) that there should be no capital gains in Canada and that we should not be imitative, because we are still a young country; (b) that we should include capital gains, after being properly defined, in an integrated tax system under the White Paper; and (c) that as an exploratory effort—and I think you were in committee this morning when we dealt with this subject matter and you were listening—that we might well start off, because of the complications of valuing farms, homes, roll-over desirability, cost evaluation and all the fantastically involved factors involved in the introduction of, shall we say, a sophisticated American type capital gains system, and that we confine ourselves for the present to a capital gains tax flat rate, in respect of purchase and sale of securities, licit or not, real estate—period—even though we know that, in the process, some taxpayers will divert to purchase and sale of items that are not covered by such categories but who may be caught, if they do it too often, because they will be traders and therefore subject to ordinary taxable income.

Mr. Goodlet: Speaking to that, Mr. Chairman, you suggested a straight flat rate capital gains tax with no progressivity in it at all.

The Acting Chairman: That is right—and not related to tenure or anything of that nature.

Mr. Goodlet: I think the position of our committee is that we would support the taxation of capital gains as an attempt to improve the overall equity of the system and we would feel there would have to be some relationship between the tax bracket of the person making the capital gain and the amount or quantum of the tax imposed upon him. In other words, the flat rate tax imposed on somebody who was in the 20 per cent tax bracket would not be particularly equitable. We would like to see an upper limit on the capital gains tax and some sliding tax effect, some progressive tax on the capital gains related to the individual's capacity.

As regards restricting capital gains tax to the gains you mentioned, such as securities

and real estate, we believe that under our present tax legislation if you were to include securities and real estate within the taxing scope you would cover most of the areas in which capital gains were made.

The Acting Chairman: Would you agree as a preliminary move that that is the simplest way to approach this new area of taxation?

Mr. Goodlet: Administratively I believe it would be more simple to extend the definition of income to include this type of gain, but we would like to see a progressive tax applied to it.

The Acting Chairman: Yes, that was your first point. You are dealing with two different points.

Mr. Goodlet: That is right.

The Acting Chairman: One, that you are not in favour of a flat rate applicable to capital gains and you would like a progressive rate in the same way as on normal taxable income.

Mr. Goodlet: Yes.

The Acting Chairman: But in respect of the category of assets that should be covered by the capital gains tax, as I understand it, you would be in favour of initially at least not trying to bite too much of the apple and start off with that part which would be easy to handle administratively.

Mr. Goodlet: It would be less desirable than including all forms of capital gains, but it would be easier of implementation.

The Acting Chairman: What is your thinking with regard to not trying to reach heaven in one day? Do you think it would be desirable to start that way and see how we get along with the initial phase?

Mr. Goodlet: We make the point in our brief that we would have preferred to have seen this approached in more gradual steps than is now possible in view of the length down the road we have now gone.

The Acting Chairman: Would you consider the suggestion that has been made before this committee as constituting your gradual approach has merit?

Mr. Goodlet: I think it has merit. It would cover the great bulk of capital gains.

The Acting Chairman: Could I get the views of your colleagues on that point?

Mr. Huggett: If you confine it to those two categories of assets, yes it will be simpler, but it will encourage people to move out of that type of asset, out of securities into objets d'art and whatever else you might have. That builds in preferences in the system which make it more inequitable.

The Acting Chairman: Do you think it could not be well covered by experience by way of amendment in due course if it happened to a significant degree?

Mr. Huggett: That is true, although my preference would be to exempt certain items of personal property, then have a blanket covering all the remainder.

The Acting Chairman: Are you not impressed by the argument that if people were attracted by the exemption and moved in and out too often they would be traders and subject to a graduated income tax?

Mr. Huggett: It is difficult to establish whether a person is a trader if he is buying to hold for long term growth.

The Acting Chairman: The income tax department does not find any difficulty in determining who is a trader; you know that.

Mr. Huggett: We have so many court cases which have been trying to establish whether an individual is a trader that we as a profession would prefer to see some of these difficulties eliminated.

The Acting Chairman: In the light of the court conclusions where it has been one elephant for the Crown and one peanut for the taxpayer, do you not think it would be dangerous for those who are exempt and buy the objets d'art and so on, and would be regarded as traders?

Mr. Huggett: It is extremely uncertain. We are not in favour of uncertainty in the tax system to the extent that it can be eliminated.

The Acting Chairman: I am putting questions in order to draw answers.

Senator Molson: Do you not think that there would be uncertainty in widening it into an area which would require an enormous number of valuations, Mr. Huggett?

I contemplate with horror the idea of valuations of all these other areas which would become taxable. I am not particularly opposed to the taxation, but to the idea of how to value and obtain a valid valuation.

Mr. Huggett: Yes, senator, this is obviously a very difficult problem. No one wishes to have their homes, heirlooms, paintings and that type of asset valued.

We have suggested in our brief that personal property and assets of that nature be valued at cost and when they are sold the gain be apportioned over the period during which the property was held. If it was held for ten years prior to the implementation of this system and was sold ten years afterwards, then one-half of the gain would be considered to be taxable.

Senator Molson: The individual could not work that out; he would have to come to the profession to get help.

Mr. Huggett: Let me say at the outset that we are not looking for more work in taxes. Those of us who are in that field have got our plates full and we do not need any assistance.

Senator Beaubien: There would be another side of the coin, because if you could get a good evaluator to put a good price on an object d'art and conveniently sell it at much less in a few years time, that would be deducted from your income tax. There would be a big angle there.

Mr. Huggett: That is very true.

Mr. Goodlet: I suggest that you would have to convince the department as to the value if you sold it at a very substantial loss.

Senator Beaubien: That is the point Senator Molson is making. Everyone would be valuing this, that and the other.

You referred to court cases. Can you imagine what kind of court cases you would get out of that?

Senator Molson: What value do you set on the valuator's value?

Do you remember during the days when there were foreign exchange controls and exceptions for medical reasons? The population of Miami went up in the winter. The regulations were fairly clearly spelled out, but I suggest to you that it still was subject to abuse.

Mr. Goodlet: I agree that any time you introduce a preference of any sort such as that for small businesses which we discussed this morning there are people who will seek to come within the terms of that preference.

Senator Everett: As I understand your recommendation with respect to capital gains, you suggest that anything that is held for less than three years be taxed as full income at full income rates; is that correct?

Mr. Goodlet: That is correct.

Senator Everett: Then between three and 13 years there would be a reduction of 5 per cent.

Mr. Goodlet: May I make one qualification to my previous answer? I said yes, the three years was correct. That is with the major exception of shares in Canadian corporations, which would be limited to the extent of 50 per cent, no matter what the length of the holding period, but for other assets the capital gains would be taxed at full income rates.

Senator Everett: When you say shares in Canadian corporations do you include all Canadian corporations, closely and widely held?

Mr. Goodlet: That is correct. The only exception would probably be in the case of those electing the partnership option, which is a special treatment, of course.

Senator Everett: So that outside of the shares of Canadian corporations, which would be taxed at 50 per cent on half the gain...

Mr. Goodlet: They would be taxed at whatever the progressive rate of the individual was, which comes to a maximum of a 25 per cent rate.

Senator Everett: Or the individual's rate on half the gain.

Mr. Goodlet: Yes.

Senator Everett: In that case your averaging rules become extremely important, do they not, if you are going to include capital gains in income even if we only take in half the gain? Otherwise, as you mention in the brief, you are taxing the gain at a high marginal rate and actually allowing the deduction for the loss at a low marginal rate. Is that not correct?

Mr. Goodlet: That is correct, except that by inclusion of half the gain in income it comes into the averaging at that point. It would be the income which would be averaged, which would include only half the gain and, of course, only half the losses would be deductible.

Senator Everett: Whether you include the whole gain or half the gain it seems to me it would be very important that you have a far better income averaging provision. If this is essential I wonder why you do not suggest excluding the gains from income altogether.

Mr. Brown: We have suggested a more generous averaging provision than that proposed.

Senator Everett: You call it block averaging. Would you explain that.

Mr. Brown: We think that the most desirable system of income averaging is the block averaging system which is permitted under the present Income Tax Act for farmers and fishermen. Under this type of system you take the income for a period of, say, five years, add it up and simply divide it by five. That is your averaging income and you then calculate the tax on that and multiply it by five. That is the tax for the whole period.

The particular type of block averaging which we have proposed is moving block averaging which will allow taxpayers each year to average their income in effect for that year and the previous four years. This type of system is relatively simple. It would provide the benefits of virtually complete averaging to all taxpayers who had some significant variations in income. If that proposal is not accepted—and we would appreciate that it would involve revenue costs—we have alternative suggestions which are offered in our brief.

The Acting Chairman: You do not seem to place any importance at all on the distinction between earned income or yield on investments and risk capital which is put on the line in a country. You seem to be ignoring the experience of other countries which take a different position.

Mr. Brown: We do indeed think there are some good arguments for taxing capital gains at favourable rates. We do not think there is any merit whatsoever in taxing at flat rates. There are very few countries in the world which do that.

The Acting Chairman: Does the United States do it?

Mr. Brown: No, it is included in income.

The Acting Chairman: They are included in income in respect to short-term tenure.

Mr. Brown: Long-term capital gains are included in income to the extent of one-half.

The Acting Chairman: Is there a maximum rate applicable there?

Mr. Brown: Not under the United States tax reforms which were adopted December 1969.

The Acting Chairman: Are they presently law?

Mr. Brown: No.

The Acting Chairman: What is the present law?

Mr. Brown: Under the law, as it was recently amended, sir, there is no maximum rate of 25 per cent of capital gains in the United States. The personal tax rates in the United States go up to 70 per cent, and this means the maximum rate on long-term capital gains is 35 per cent which is one-half of the maximum of personal income tax rates. This change was just introduced in their system and it will be fully effective about 1972.

Senator Everett: What is the argument against the flat tax on capital gains?

Mr. Brown: It imposes far too high a burden on low income people who earn low capital gains and a high burden on people who earn high capital gains. We think the burden of capital gains should be computed by reference to the income position of the person who is receiving it. We do not feel that there is any justification or any type of flat rate of capital gains which would impose a tax without relevance to the income bracket of the person receiving it.

Senator Everett: There is a difference between saying that up to the maximum rate you can pay your marginal income tax rate if it is lower, but the rate will not go over 25 per cent.

Mr. Brown: In effect, that is the recommendation we have put in our brief.

Senator Everett: Not necessarily, because you have to introduce this in order to make your system workable, an increase averaging system, which indicates that you are just taking income regardless of where they put the personal rates. For example, you have to suggest that there be no transition rates in order to make your scheme work.

Mr. Brown: That is correct.

Senator Everett: Let us go on to your scheme.

The Acting Chairman: May I put one question before you do so? In coming to your conclusions have you given any consideration to the point that if we are interested in foreign capital coming into our country from countries that are not subject to capital gains tax and who are not reachable, that we are practically encouraging the handing of our natural resources and development to non-residents by subjecting Canadians, in respect of their savings and risk investments, to a rate of taxation which is discriminatory and in favour of non-residents?

Mr. Brown: It is difficult to take that argument too far, because there is no tax system whatsoever in the Bahamas.

The Acting Chairman: Let me say it differently. Do you feel that the accumulated savings in Canada, in respect to the high tax rates we have now, are sufficient to warrant or provide the capital for the expansion of our country?

Mr. Brown: No, sir, we have relied on foreign capital.

The Acting Chairman: Therefore, you wish further foreign capital to come in. Do you think that foreign capital should be given a tax advantage in relationship to savings by Canadians who put their money on the line by way of risk for the development of industry?

Mr. Brown: I think, senator, that the argument is that if you are going to require foreign capital to develop our economy, the rate of tax on that foreign capital is at least partly taxed from where it comes. If it comes from the United States it is subject to relatively high rates of capital gains tax and if it comes from Switzerland or the Bahamas it probably will not be. The tax system in Canada must be computed to a large extent by what is accepted and normal in world circles. That is one of the reasons we object to some of the White Paper proposals.

The Acting Chairman: You say it is accepted in countries which have pools of capital and that they would be subject to rates of taxation equal to or greater than those you are recommending.

Mr. Brown: The major industrial countries of the world all have relatively high taxes on

capital gains. The United Kingdom, United States, Japan and Germany all have rates on capital gains which go to 30 and 40 per cent. Under our proposals the great bulk of Canadian capital gains would not be taxed at rates in excess of 25 per cent. Over 80 per cent of all capital gains coming from shares, under our proposals, would not be taxed at the 25 per cent maximum.

The Acting Chairman: Why do you draw the distinction discriminatory-wise in favour of shares?

Mr. Brown: This is a pure incentive decision.

The Acting Chairman: Do you think a man who had a farm and developed it lived on it 40 years is entitled to less consideration than a man who has stock in a listed company?

Mr. Brown: No.

The Acting Chairman: You do not propose to make the distinction? I thought you said you wanted to give the benefits of lower rates to those in respect to profits made on shares in listed companies.

Mr. Goodlet: The immediate low rate would be on shares in companies, but the farmer who built his farm up and held it for 13 years would also be taxed at the same maximum rate of 25 per cent of his farm.

The Acting Chairman: The farmer would have to slave for 13 years whereas a person who, after three years in your system, could telephone his broker and get the same benefit.

Mr. Goodlet: There is also a provision in regard to principal residences. I suggest there should be a minimum exclusion for principal residences, which would include farm houses. This would build up an exemption in that area as well.

Senator Beaubien: Could I ask a supplementary question before we go on? Mr. Brown, in your system would you have all capital losses deductible from income?

Mr. Brown: We deal with that in our brief. We would like to have them deductible to the greatest extent possible. We recognize that once you move to a system from where you tax capital gains only on realization, it is difficult to allow the full deduction of all capital losses because taxpayers can select against the Government, realizing the losses on the shares which have gone down, or the

assets which have gone down, and postponing tax on the assets which have gone up. We suggest that any taxpayer who has suffered a net capital loss—his capital assets having gone down in value—should be allowed the right to deduct this against his other income.

Senator Beaubien: In other words, if all the shares you owned in the stock exchange were down you could sell and deduct it all?

Mr. Brown: That is correct.

Senator Beaubien: In that case the Government would take a big loss this year in revenue.

Mr. Brown: It certainly would.

Senator Everett: Let us assume that we have an inflationary economy such as we had in 1969 and a taxpayer who bought a residence for \$30,000, five years earlier and sold it for \$50,000—which is not out of the way in terms of the period from 1964 to 1969; who bought a painting for \$10,000 and sold it for \$20,000, in a matter of two years, which has happened; bought some stocks, which he held for five years and enjoyed a capital gain on; bought other stocks on which he suffered capital losses; and let us assume that the gain was realized in five years and the losses were realized in two years; I would imagine that that man would find himself, on your proposals, in an extremely difficult and complicated accounting situation.

On the residence, which cost more than your \$25,000 limit...

Mr. Goodlet: The \$25,000 lower limit, sir. The \$30,000 would be his starting point.

Senator Everett: Yes, that is right. I am saying that the \$25,000 is not applicable. The ten years at \$2,200 a year would mean \$21,000, bringing him to \$41,000, so he would have a nine-year gain in five years.

Mr. Goodlet: The assumption is that he does not buy another house—is that correct?

Senator Everett: There is no rollover.

Mr. Goodlet: We are proposing a rollover.

Senator Everett: There is no rollover in this case. You have now a gain of \$9,000. You would have to compute the tax rate there, because he has held up for five years, and, if his upper marginal rate, which it obviously would be in this case, is 50 per cent, where would he be now?

Mr. Goodlet: He would bring \$8,100 of a gain into income—two years beyond the three-year limit.

Senator Everett: Then we get into the painting, where he has got a cost of, what did I say...

Mr. Goodlet: \$10,000.

Senator Everett: He held that for two years, so that makes his cost \$12,000.

Mr. Goodlet: No sir, that would make his gain \$10,000. That is all.

Senator Everett: I thought there was \$1,000 a year deduction.

Mr. Goodlet: I see. Right.

Senator Everett: So he has an \$8,000 gain, right? And the rate on that is what, now, because he now has that?

Mr. Goodlet: Within two years, this would be a full inclusion income.

Senator Everett: Of course, a full inclusion income. He is under the two years there. This is getting so complicated that I am forgetting where I am.

Senator Beaubien: I did not know you were in such a helluva mess.

Senator Everett: Then he has got a gain on the amount of the shares.

Senator Beaubien: He is an accountant.

Senator Everett: Anything you want to give him. He has got a gain there which is computed at half his marginal rate. He has got losses in there that will reduce his marginal rate below 50 per cent. He has to use your system of moving block averages to determine what his income was between the second and the fifth year. You say you do not want business, but I must say that...

Mr. Goodlet: We are going to get it.

Senator Everett: In the way you define it, you will get a lot of business. This is more complicated than the White Paper. What is the rationale for having a reducing capital gains tax? What is the rationale for the complicated, extremely complicated, provisions on personal residences, when in fact you could have suggested simply exempting personal residences—and you have all sorts of precedents for that in other countries throughout the world. What is the rationale for getting into a complication of saying that any asset

over \$1,000 must be valued and then you can add \$1,000 a year to it? What is the rationale for going along with the White Paper on the \$200 a year for repairs, so that the fellow has to keep an accurate record year after year of his repairs?

I am beginning to see now how the White Paper was written.

Senator Beaubien: And the Carter Report, do not forget?

Mr. Goodlet: I am not sure I can cover all your points in the order you raised them, but there are a number of reasons for reaching the conclusions we did.

First of all, the inclusion income we have already discussed. We feel there should be progressivity in the taxation of capital gains. This then involves us with an inclusion in income rather than with a flat rate capital gains tax.

I think the second question you asked was why have a reducing amount of inclusion in income over a period of time. One of the difficulties that can be created by a full inclusion of income up to, say three years, and then an immediate drop to 50 per cent inclusion in the fourth year or any other time break like that, is that you introduce tremendous distortions, people will hang on and get locked into a position for a period and will hold on waiting for that date which is coming. We felt that it would be better to have a gradually reducing amount of inclusion in income so that you would not have this.

Senator Everett: Let me ask you this. Let us assume that the main is in business of buying and selling property. Certain properties he is going to turn over within six months; but there could be properties that he is not going to turn over for thirteen years. It has happened before now. In fact, I suppose it happens rather frequently with a developer. Does not the quality of the gain have some effect?

Mr. Goodlet: Yes. There is an in-built assumption here—in fact, I think it is stated somewhere—that this does not include inventory, which would be the developer you described. He will be taxed at full rates on his income, no matter how long it took him to realize his gain.

Senator Everett: If you exclude inventory and take inventory into income, why not make that the definition? You see, most people who have appeared here have said:

"by all means take inventory". A lot of people have been against the time rule, the six months' rule, the two year rule and have said, "judge it as inventory or judge it as a capital asset, try to indicate rules on which a court can make that decision." You have both rules—you have an equality rule and you have an effluxion of time rule.

Mr. Goodlet: We have an equality rule which is presently under the existing tax system. We have a great deal of legislation covering this area of the definitions. It is not completely clear. But we feel that a three-year minimum holding period would certainly eliminate a great number of the grey area situations as to whether they were income gains or capital gains.

Senator Everett: I disagree with you, because I think that as soon as you got into it the department would assess on the basis that it was income, because it was inventory; and the taxpayer would appeal; and the fact that there was a time limit would make no difference at all.

Mr. Goodlet: Within the three years of course it would not matter.

Senator Everett: It is all right up to that point, but beyond that you would have the same number of appeals as you do today.

Senator Cook: I am sorry to interrupt, but I have to get to another meeting.

The Acting Chairman: Yes. We will have to close out here here by 3.30, so my suggestion is that we deal with fundamentals, because we have people here from Vancouver to hear and we wish to hear them this afternoon.

Senator Cook: Could I direct our guests' attention to paragraph A.15 on page 3 of their brief, which I wish to take the liberty of reading, because it is very important. It reads:

Although the existing Canadian tax system contains technical and administrative weaknesses that require attention, we are by no means convinced that it deserved the level of criticism directed at it at the time of the appointment of the Royal Commission on Taxation. Subsequent events have shown that, given a firm stand by the tax administrators, some of the weaknesses of our present system were more apparent than real. Acknowledging as we have the need for a widened tax base and relief from

taxation at the lower end of the income scale, we would have preferred to see this achieved by a more gradual transition from the present system. Our conviction is that it would be preferable to proceed with caution in an area of such uncertain consequences as tax reform.

I agree wholeheartedly with this paragraph, however, what would be your order of priorities in the introduction of tax reform assuming we do not want the whole packages outlined by the White Paper?

You know the whole problem very well from coast to coast, person to person and company to company.

Mr. Goodlet: The comment there was based particularly on the fact that we would have preferred to see a more gradual approach.

With the White Paper proposals down we did not have the same flexibility. We are in a situation where some of the reform has to go forward reasonably quickly in order to remove the uncertainties that have been hanging over the field for a few years.

We have not discussed the order of priority in committee.

Senator Cook: Perhaps you would let us have a supplementary brief regarding that point.

Mr. Goodlet: We would have to retain a balance of revenue and expenditures. For example, the granting of relief to the lower income groups requires a reduction in government revenues. One would have to impose something to balance that out. I suggest the capital gains would go with that as one of the reasons for the compensation.

The Acting Chairman: Gentlemen, we have a time problem because of the other items raised here. We have a group who have come from the very end of our country. With your approval I would like to close out the representations and suggest that honourable senators read the brief carefully. However, there is one point I wish to make with reference to page 6 of the brief in the introduction. I ask you, as experienced gentlemen, to read with me your paragraph:

We believe that adequate time should be allowed between the introduction of any bill to reform the tax system and its final enactment so that there is time for interested parties to make a detailed review of the resulting legislation.

Are you not aware of the fact that, under the present parliamentary system in the British Commonwealth, once an income tax bill is brought down by the Minister of Finance with rates of taxation and application thereof it usually becomes the law of the land?

Do you think that there is any reasonable merit to your expectation that that paragraph has any value?

Mr. Goodlet: Mr. Chairman, that paragraph is not directed to rates of taxation, nor principal thrusts. It was intended that when the bill is brought down setting forth the policies of the Government adequate time be allowed to review the detailed legislation.

The Acting Chairman: But what bill? The bill to reform the tax system includes a new Income Tax Act with rates of taxation and new categories to which people are subjected in respect of taxation.

Do you seriously think that under the British parliamentary system this paragraph has any significance?

Mr. Goodlet: This refers to the need for technical amendments.

The Acting Chairman: But "to make a detailed review of the resulting legislation". In other words, you expect the legislation to go through as soon as it is tabled by the Minister of Finance, do you not?

Mr. Goodlet: The main thrust will become the law of the land, yes sir.

Senator Molson: I would like to ask one general question in two parts, because I am puzzled and would like the members of the Institute to accept the question in that way.

We had a long discussion with reference to personal exemptions. The recommendation of the Institute on page 5 is that the Government again review the desirability of introducing tax credit in lieu of personal exemption. We had a long discussion with respect to capital gains and the suggestion that it be based on income.

I turn to page 14, paragraph C.2, and find the words:

...we do not consider that it is appropriate to tax all types of capital gains as ordinary income.

I find the brief to be inconsistent to some extent with what has been said this afternoon. I am probably wrong, but it is my impression.

Mr. Goodlet: I can speak to the second question and I will ask Mr. Brown to speak to the first.

Our proposals are not to treat all types of capital gains as ordinary income. We have a reducing inclusion of the amount of gain in income, as opposed to a hundred per cent. We have a special preference for shares in Canadian corporations and to that extent it is not being treated as income. It is being brought into the income rate structure but not as ordinary income at half rates, let us say, after a holding period of a certain time.

Senator Molson: Later on in your brief you say that they should all have separate rates.

Mr. Goodlet: We say that in the event that the transitional rates are not limited, in other words if the top rate is not reduced to approximately 50 per cent immediately, then we should have special rates.

Mr. Brown: With respect to your question regarding tax credit, our point is that we support the proposal to increase personal exemptions. However, we see the points you brought out, senator, that this perhaps can be done more efficiently through a system of tax credits so that all of the relief goes to the lower income taxpayers, the position of taxpayers above that is not disturbed and it can be done at reasonable total revenue cost.

Senator Molson: It is most important. It is one of the subjects that we have concerned ourselves with in this committee and it should be abundantly clear that that is your recommendation.

Mr. Brown: It is, sir.

Senator Desruisseaux: Has this presentation been submitted to your members and received full approval?

Mr. Goodlet: The tax committee, as I said in my introductory statement this morning, must accept final responsibility for this brief. When reaching our conclusions we drew on as many members of the profession as we could by referral to our provincial taxation committees, who in turn consulted their memberships. However, the brief has not been passed by our executive nor has it been submitted to the entire membership for approval.

We make a point that this does not necessarily reflect the views of all chartered accountants.

Senator Molson: Do you think anything would ever be the view of all chartered accountants?

The Acting Chairman: Thank you very much, gentlemen.

The Acting Chairman: Gentlemen, the next presentation, and the last one on today's agenda, is by the Vancouver Board of Trade. Will the gentlemen representing the Vancouver Board of Trade please be good enough to come forward. Gentlemen, you are welcomed here from quite a distance. I think you have sat in the greater part of the day and you are familiar with the procedures we follow. I imagine you would like to make an introductory presentation.

Mr. E. W. Disher, President, Vancouver Board of Trade: Mr. Chairman and honourable senators, we are pleased to be given the opportunity to discuss our brief here in Ottawa.

We wish to make it clear at the start that the Vancouver Board of Trade is in complete agreement with the objectives expressed so strongly in the White Paper that equity and minimization of tax avoidance and evasion are in themselves highly desirable aims.

Where the board differs from the White Paper approach is that we consider that the ends of equity and minimization of avoidance can be achieved in large measure by working through the existing tax structure without introducing sweeping new proposals whose economic effects on the nation's growth would be unpredictable.

In the area of tax abuse, the board disagrees strongly with the emphasis placed on this factor by the White Paper. We suggest the main facets of tax abuse have been curbed in recent years by vigorous assessing practices. Furthermore, such areas of abuse as do remain could be cured to a substantial extent by relatively simple amendments to the present Act and Regulations.

With respect to the question of tax abuse therefore we contend the White Paper's use of the term is a shibboleth. In any case, there is no reason to expect that avoidance and evasion will not exist under any new system.

With respect to the desire to increase the fairness of the Canadian tax structure, there would appear to be two subjects for discussion.

First, the relief of low-income taxpayers is an absolutely essential matter and the board

agrees with the White Paper sentiments. However, the revolutionary package of the White Paper is not necessary to achieve such an end. The relief could be achieved by relatively simple modifications of the present Income Tax Act. There is, in fact, no reason at all why such relief need have waited for the production of either the Carter Report or the White Paper.

It is true that such relief would diminish the revenue flows to the government, but, had a scrutiny of government expenditures been made as intensively as that to which the revenue side of the picture has been submitted in recent years, it would seem safe to contend that compensatory savings would have been achieved.

However, from a viewpoint of financing such relief by increasing the revenues in other areas, the board's brief does contain certain concrete suggestions which would assist in this area.

The second extremely important discussion point relating to equity is the taxation of capital gains.

Undeniably the beneficiary of a capital gain has increased his ability to command goods and services. A tax on capital gains must, therefore, be regarded as equitable taxation procedure. However, the psychological and economic effects of introducing a capital gains tax—particularly as severe as set out in the White Paper—in a country such as Canada are quite unpredictable. The board is unconvinced, therefore, that the consequences of a capital gains tax would be as marginal as the White Paper suggests.

If however for political reasons the government feels it is necessary to tax capital gains, then we urge that any such tax should result in the minimum discouragement to investment. To this end we favour a distinction being drawn between short-term speculative profits and long-term investment gains. In other words, the tax should not discourage genuine domestic or foreign investment and definitely should not place the taxpayer in any worse position than does the American system.

I have with me today on my right, Professor A. R. Ilersic, Professor of Social Studies in the University of London, and since 1951 United Kingdom correspondent for the Canadian Tax Foundation, who has assisted us in preparing this brief.

Next to Mr. Ilersic is Mr. D. H. Parkinson, a chartered accountant and current Chairman

of the Vancouver Board of Trade and Mr. Walton, a chartered accountant and Vice-President of our Taxation Committee. We are ready, Mr. Chairman, for any questions.

The Acting Chairman: Thank you very much, Mr. Disher. I think we will advance matters considerably if we realize that your brief is divided under two headings, one, the detailed study by Professor Ilersic, which is in part A of the brief and secondly, the two major points you have just made in your summary, and that is the question of relief for various categories of taxpayers, particularly those in the lower brackets and the whole question of capital gains. You have listened to the discussions which have taken place here with respect to the proposal for the elimination of some 750,000 taxpayers in the low income brackets. You have listened to the discussions with respect to the proposed increase of exemptions involving loss to the treasury of \$1.2 billion and offset by shunting of increased tax liability in upper categories. Could we get the benefit of Professor Ilersic on his thinking in regard to this point?

Professor A. R. Ilersic, Economist—Tax Consultant: These exemptions will run right through the scale from the smallest income recipient to the highest and, in point of effect, they are of major benefit to the highest tax bracket.

In the Minister of Finance's newsletter dated March 6, 1970 Table 15B-2 shows the effect of such changes.

Taking that billion dollars worth of relief as a result of the basic exemption, one finds that only \$50 million comes to the income group in excess of \$15,000. The balance is distributed to the lower income groups. The case for increasing the Tax free allowance to the lowest income groups is self-evident. May I refresh your memories, gentlemen, by taking the latest available figures of income distribution, those for the year 1967. These are in *National Finances 1969-70*, published by the Canadian Tax Foundation. In 1967, only one per cent of your taxpayers received more than \$20,000 a year. Just over another one per cent received between \$15,000 and \$20,000 a year. Five per cent received between \$10,000 and \$15,000 per year. In other words, 7½ per cent only of your taxpayers received in 1967 more than \$10,000.

At the other extreme, 47 per cent—almost half of your taxpayers in 1967—earned between \$4,000 and \$8,000 a year and, inci-

dentally, they paid just over 40 per cent of the total tax revenue.

When you propose, as is suggested in the White Paper, for relief right along the scale with the primary object of relieving the lowest income groups and this, after all, is the object of the exercise, then the additional revenue required by the Government to offset this concession has to be found elsewhere. It is quite clear that it cannot be found, as was suggested by your previous witnesses, at the top end of the income scale. It must come from the middle range of incomes. In other words, it must come from people whose incomes are in excess of \$10,000 a year rather than those with \$20,000 and more. This is the basic problem, sir.

The Acting Chairman: What is your conclusion?

Professor Ilersic: There are a number of solutions which, of course, would completely disrupt or destroy the whole basis of the White Paper and, in particular, the attractive feature of the top rate of 50 per cent. You could, for example, extend the scale of rates to say 65 per cent, and have a faster rate of progression. In other words, instead of starting your 50 per cent, say, at \$40,000...

Senator Molson: I think it is \$24,000.

Professor Ilersic: I am sorry: I am confusing my English and American figures. You could reduce this upper limit up and even flatten out the progression somewhat but take a little more at the top. Somewhere from this reasonably wealthy group with incomes of \$15,000 to \$25,000 that additional revenue will have to come.

While I am on this point, sir, I should say that in our memorandum we criticize strongly the White Paper's estimates and question that the capital gains revenues will be anything like as high as they believe. In other words, sir, of the \$600 million surplus that you refer to, more than half of that comes from the capital gains provisions. What I want to say, is that if the revenue from those gains is not realized—and personally I do not believe it will be—then straight away a large part of the foundation of underlying assumptions, if you like, of the White Paper falls apart.

The Acting Chairman: Does that lead us to your two-way conclusion, that you do not think these increased exemptions referred to in the White Paper should be followed through?

Professor Ilersic: What the Government has to do is to assist the lower income earner; that they must do, faced with inflation and the general question of poverty. Bear in mind, sir, according to the Economic Council of Canada 27 per cent of your population are living in poverty, poverty being defined as incomes of under \$1,500 for a single man and \$2,000 for a married couple, with \$500 for each additional child. This is a striking figure. There is no scope here for, shall we say, delay. The answer may be, of course, in the form of a negative income tax; it could be in the form of welfare payments. There are a number of possibilities, but there is no point in going into these now. However, they all add up to the same thing. The revenue to meet these costs will have to come from those people who in financial terms are more favoured.

The Acting Chairman: If we were not to impose the extra tax on the groups, say, roughly from \$12,000 upwards, is your conclusion that we should not grant the exemptions contemplated by the White Paper?

Professor Ilersic: Only if the Government is prepared to incur a substantial deficit on its revenue, on its budget.

The Acting Chairman: Only if we were dealing with deficit financing?

Professor Ilersic: If you were prepared to, and in the inflationary situation in Canada at the moment this would be absolute heresy.

The Acting Chairman: So in effect you are recommending that we do not grant these exemptions as contemplated by the White Paper?

Professor Ilersic: I would not go quite as far as that. You refer to "these" exemptions. The exemptions in the White Paper go all the way up the scale.

The Acting Chairman: I am speaking of the \$1,400 and the \$2,800, I am specifying those.

Professor Ilersic: Well again, sir, they go all the way up the scale. They go to the rich man as well as to the poor man.

The Acting Chairman: Exactly.

Professor Ilersic: I would restrict them.

The Acting Chairman: You would restrict them or eliminate them?

Professor Ilersic: Eliminate them, and provide benefits to the lower income groups in some other way.

The Acting Chairman: Which would you prefer, elimination or restriction?

Professor Ilersic: I think it would have to be elimination, and with the resultant tax revenue you could go a little higher in helping the lowest income groups than you go at the present moment.

Senator Aseltine: How about tax credits?

Professor Ilersic: There is no reason why you should not have a system of negative income taxes, if that is what you mean by tax credits. These people have no credits to be paid out of tax. Offering them, say, additional tax allowances, is useless to them, because they have no taxable margin. They are out of the income tax system for all practical purposes. All we can do for these people is a form of negative income tax, whereby you set an overall allowance of, say, \$2,800 a year for a married couple, and any couple falling short of this income would automatically be given a welfare benefit or negative tax benefit of the amount needed to bring them to this level.

The Acting Chairman: Professor, we can only at the moment relate ourselves to the White Paper we are considering. Do you feel that the suggestion of the increased exemptions is not desirable at the present time?

Professor Ilersic: As expressed in the White Paper, no.

The Acting Chairman: Completely out? Or would you allow the exemptions to a specified lower category of income?

Professor Ilersic: I think you would have to assist the lower paid taxpayer in some different way, not by tax exemptions.

The Acting Chairman: Not by tax exemption. That is the point.

Senator Beaubien: Would you say, professor, that a man earning less than \$1,400 would pay no tax?

Professor Ilersic: That goes without saying, given the deposition of poverty.

Senator Beaubien: And a man earning \$2,800 would pay no tax. We have already had a submission of that kind, Mr. Chairman.

The Acting Chairman: Yes, we did. I think, if I may say so, that clarifies that point. Now what about capital gains?

Professor Ilersic: Which particular aspect of capital gains?

The Acting Chairman: On the assumption that we have to have a capital gains tax in Canada, what do you think would be the most desirable form at the present time, and what should be its fundamental features?

Senator Beaubien: Less undesirable, sir!

The Acting Chairman: Yes, on the assumption that we do have one.

Professor Ilersic: May I start by explaining why I object to the White Paper proposals. First, the proposed rates would be higher than in any other country in the world. Secondly, if in fact you fail to reach the objective—and I am confident the Government will fail to bring down the top rate to 50 per cent—you will then be left taxing capital gains at a rate in excess of 50 per cent—it could well be 60 or 65 per cent. In a period of rapid inflation this could mean virtual confiscation of those gains.

The problem that again must be emphasized here, which was only half touched upon by previous witnesses, is the whole question of bunching of gain. The basic difficulty in any system of taxing capital gains lies in the fact that most gains accrue over a period of years. In that case you may have, as somebody said here earlier a picture bought for \$10,000 and sold ten years later for \$30,000. On the proposals in the White Paper, that \$20,000 would become income of the year chargeable at the taxpayer's marginal rate, at the taxpayer's top rate. This, quite frankly, in an era of inflation, is in my view quite ridiculous and far in excess of anywhere else in the world.

On the question of the loss concessions, the proposed loss offsets in the White Paper are, in my view, unworkable, for reasons which in fact were dealt with about half an hour ago. If you give an individual a right to set his losses on capital transactions against his ordinary income, then those individuals could substantially reduce their taxable income. The classic case is the 1931-32 depression in the U.S.A., when the Senate committee reported in 1932 that losses equal to 27 per cent of total income tax yield were sustained—since wealthy people effectively wiped out large chunks of income by taking

paper losses on securities. In no country in the world are 100 per cent loss offsets of this kind granted, for the simple reason that the taxpayers can time their losses at their discretion to reduce their ordinary income. This is the weakness here.

It would be better, to be constructive, not to impose in Canada a tax any heavier than has just been imposed upon citizens of the United States. Also, while I recognize all the strictures on the American capital gains tax, a large part of those problems could be eliminated. The Americans charge top rate of 25 per cent on long term gains and short term gains, which have been realized in less than six months, are taxed in full as ordinary income.

Senator Benidickson: When you say "full", you mean the personal income tax rate, the progressive rate?

Professor Ilersic: Exactly. There is 100 per cent inclusion of the gain realised within six months of acquiring the asset, and after that it is 50 per cent inclusion of the gain at the marginal rate of tax. That makes the top rate up to, until just recently, 25 per cent; the rate may soon be raised.

Some discrimination—or differentiation may be the better word—must be made between what are, in effect, investment gains and what are short term speculative profits. For example, take the case of a man who has \$20,000 a year and who is speculating on the securities markets, in real estate and so forth; and take a man also with \$20,000 p.a. who was left \$25,000 worth of assets by an elderly aunt 20 years ago and decides now to sell them. They both, make say, \$10,000 gain that year. The White Paper proposes that those two individuals be treated in exactly the same way. I find that quite irrational and it will be quite unacceptable to public opinion.

The Acting Chairman: We think this view is the view which has been expressed by a great number of taxpayers in this country, as distinct from the one expressed 20 minutes ago by Mr. Brown, as one of the spokesmen for the Chartered Accountants.

I may say, professor, that your views fit in with those of practically everybody who has come before us and who has stated that they want a special rate for capital gains, if we are to have it, and that the rate should not exceed 25 per cent.

Professor Ilersic: In my view, it should—given Canada's need for capital—be less than 25 per cent but certainly not more than 25 per cent.

Senator Molson: We had not heard that the American rate was 35 per cent, until this afternoon.

The Acting Chairman: Yes, and the indication was that it is not yet the law of the land.

Professor Ilersic: With the greatest respect, may I add one point? Both the British Minister of Finance, Mr. Callaghan, in the United Kingdom in 1965; and more recently Mr. Benson, in Canada, have been telling the public that America has a capital gains tax—which does not affect their incentives—and they have had 50 years of it.

I would point out that for something like 25 years the American capital gains tax has been the major vehicle for tax avoidance for the well-to-do. Nobody pays the top rates of American taxes—or at least only a handful of taxpayers. They merely exploit the capital gains tax provisions. That is why nearly two-thirds of the Internal Revenue Code is now designed to try to block a multiplicity of avoidance devices which this tax has provided, largely as a result of the attitude of Congress.

The Acting Chairman: Professor, what do you think of the suggestion that initially we should confine the capital gains tax to categories that you have heard today, to wit, securities only of all types of companies and real estate, and take our chance for the present that the *smart* taxpayer here and there, smart being italicized, may escape the odd rate of capital gains for a while.

Professor Ilersic: American experience and, I think, the British experience shows that roughly 85 per cent of all capital gains are in fact achieved in those two areas, sir. So that what you miss out is not so important. This illustrates perfectly the basic problem in capital gains taxation. Any capital gains tax is a compromise between equity on the one hand and administrative convenience on the other. It is, if I may say so, inequitable that you should omit certain exempt categories of property from this tax because, as the Chairman has pointed out, it is possible, and we have done it in the U.K., to buy, stamp collections, objects d'arts, paintings and so forth and build up the collections and then pick up the profits as well as you can. Such practices would cer-

tainly develop in Canada. But, on the other hand, from the point of view of administration, it is frankly, in my opinion, and certainly in the light of recent U.K. experience, impossible for the Department of National Revenue in this country simply to take on such a task as is posed by the White Paper proposals. I think the particular provision in respect of personal assets on the proceeds of \$500 would lead to wide-scale evasion, and there would not be at twinge of conscience by anybody doing it. From the administrative point of view, therefore, sir, and also from the revenue point of view which is important, I would say that if Canada must have a capital gains tax, this is a compromise solution.

The Acting Chairman: Good. Do you think from your experience that there are many people in the country—after all the odd person here and there is a tax evader, but 90 per cent are taxpayers and there is the odd tax avoider who minimizes taxes but do you think, within the framework of the statute that it is significant, and I know I am repeating the same point, if we eliminated for the present profits other than those to which I have referred.

Professor Ilersic: Well, as I said, sir, in theory it is inequitable because it means that some 15 per cent, if we take American and U.K. experience as a guide, of capital gains would escape tax. It could be more because clearly if you are offered this opportunity to avoid the tax, people will begin to exploit it. Given the technical administrative problems, this proposed limitation, I think, is really your only practicable course. If I may say so, sir, the problem of administering the capital gains tax in the United Kingdom coupled, of course, with the new corporation tax since 1965 has imposed a tremendous strain upon the Inland Revenue. The Select Committee which investigated the state of the Inland Revenue last year stated categorically that the Inland Revenue was quite incapable for at least another three years of taking on any more tax changes of significance. In other words, for the last five years, the Inland Revenue of the U.K. has been stumbling along under the weight of two basic changes, a capital gains tax and a corporation tax, and the latter is not all that difficult to operate. The U.K. Inland Revenue is not the same situation as far as staff is concerned as is the Canadian, hence the difficulties have been aggravated. But, I think it is an aspect of this issue to which administrators should pay attention.

The Acting Chairman: This is very interesting. Now, with your background as an author of note, could you give us a little guidance on the question of small businesses?

Professor Ilersic: As far as small businesses are concerned, sir, this is ultimately a political decision. Four-fifths of the businesses in Canada and likewise in the U.K. are in fact small. But how you define "small" is here again a matter of judgment. The Bolton Committee, which is inquiring into the problems of small businesses in our country at the present moment, has defined it as a business with under 200 employees. This, I think, sounds rather ambitious, because in such a business the turnover can be well over a million pounds. Let us compromise on what we mean by small business; we all have a pretty good idea of what we mean by small businesses. But how you give relief is the big problem, because accelerated depreciation and other such suggestions are, of course, of no value in a business which is engaged in the distributive trade, although it may be extremely useful for a small manufacturer. Frankly, I would go so far as to say that economically and, particularly socially, the small businessman warrants some support from the Government. I think of them in the same way as we used to consider the yeomen of England, the yeomen farmers, as good stock, who deserved encouragement.

The Acting Chairman: They had a way of winning battles too.

Professor Ilersic: Well, certainly, sir, and when I view what the Government does with an awful lot of the taxpayers' money, I do not get very hot under the collar because the small businessman may in fact be subsidized. I would modify the 21 per cent up to \$35,000. I certainly would not be as generous. I think perhaps something more could be done to block this loophole for avoidance which frankly, as far as I can see, is the main reason why the Government is so anxious to resolve this problem. Mr. Parkinson is much more expert in this field than I am.

Mr. D. H. Parkinson, Chairman, Taxation Committee, Vancouver Board of Trade: I think the precise definition of "small business" is not terribly important, and I think it is not important for the same reasons that you are putting forward with respect to the concept of capital gains limited to certain types of assets. There has not been a definition. We have had the dual rate of tax

apply right across the line. We have lived with that for so many years. Now, it clearly contains flaws. If we do something to get rid of those flaws, we have improved the situation materially from what it is now, and I do not think it is necessary to get down to a point of exactitude as to what is and is not a small business. I am suggesting a perfectly arbitrary approach, that we take a ceiling on the low rate of tax. Whether it be \$100,000 of profit, \$75,000, or a test measured by total assets combined with profits or assets and payroll, it does not really matter too much. It is a question of preference detail. It may be appropriate to put in a time test as well, so as to differentiate between the new business and the one that is dribbling along forever and not getting off the ground. But fundamentally we are saying, I believe, that the dual rate concept is possibly the most universally effective because, as Professor Ilersic said, if you choose the accelerated depreciation rate it clearly is not going to benefit certain types of perfectly useful businesses, so that the lower rate of tax for a given amount of dollars has universal application, is relatively simple and we are used to it, and, therefore, let us stick with what we have, but cure, to a large extent, the flaws existing in the present system.

The Acting Chairman: Are you in favour of the low rate of tax, but conditional upon the tax being exigible when the profit has been distributed by way of dividends to the shareholders, if it were a corporation; or would you simply, in the over-all concept of helping small businesses in the economy of the country, call it a day and say the profits of a corporation—and I am not too much concerned about fancy bookkeeping, because the administrative taxation system could look after that, because we have enough sections in the law to deal with tax avoidance. But would say that if the profits of a corporation were, say, \$100,000 and we applied the lower rates of taxation up to \$35,000—in other words, a small business is one whose profits do not exceed \$100,000 in a given year and the lower rate applies up to \$35,000—period. Would you give that concession completely, or a mere deferral?

Mr. Parkinson: No, I think we would suggest that we give that concession completely. You would have to introduce, obviously, a notch provision to avoid suppression of income just over the \$100,000, and it is also open to a degree of abuse by putting nephews and cousins on the payroll. But one of the

points we make strongly, and I have been making strongly elsewhere, is that there have been for years perfectly adequate tools in the Income Tax Act that have only begun to be used efficiently in the last, say, five years by the Department of National Revenue, and sections 12(1)(a) and 12(2) would be quite adequate to prevent this sort of thing happening.

The Acting Chairman: I mentioned that earlier today. There was an amazing remark made that a corporation controlled by an individual could take a salary equal to the total profit. Sections 11 and 12 of the act cover that easily, and it just could not be done; and, of course, he would pay tax on the high salary, so it would defeat the very purpose of it.

Mr. Disher: We have suggested in our brief the elimination of the advantage once you get up to the \$100,000 figure in that area.

The Acting Chairman: I am most anxious to get your thinking on that.

Mr. Disher: I would like to add one more thing which I have said before, being a small businessman. This is a simple approach and it is very easy to understand that when you work on other kinds of methods of doing this you complicate it for the small businessman who does not have a high salaried or a very brainy chartered accountant, or someone else on his staff to do some of the complicated things for him.

The Acting Chairman: Frankly, I am glad to hear you say that. You were here during the day when I made some observations. The reason for this was to get the debate rolling. My views are only my own. We have explored capital assets, depreciation, subsidies, deferred taxes and all that sort of thing. We seem to have ended up provisionally with a feeling that the simplest definition that is related to profits not in excess of \$100,000 in a given year is a flat benefit to a taxpayer on the low rate up to \$35,000. Let that taxpayer become a middle taxpayer and God bless him and we hope that he will be a big taxpayer as he goes on. Doesn't that strike you as making sense?

Mr. Disher: Yes, sir.

Senator Isnor: You say you are a businessman. How did you arrive at that \$35,000 limit—\$100,000 net profit? That is what you base it on, \$100,000 net profit.

Mr. Disher: After the \$100,000 profit has been reached the advantage of the 21 per cent rate on the first \$35,000 disappears to the taxpayer.

Senator Isnor: The net profit of \$100,000?

Mr. Disher: You have, as Mr. Parkinson said, a notch provision on it, but the advantage of the 21 per cent rate is eliminated completely. A corporation making \$1 million pays a 50 per cent tax on all of its profits.

Senator Isnor: That would mean that the small businessman you have in mind would have a turnover of, roughly speaking, \$4 million to \$5 million?

Mr. Disher: I would not say necessarily. There are a lot of small business who are probably having net earnings without sales of that size.

Senator Isnor: What size would you say? I want to get to the foundation of this. We have been talking of \$100,000 as a small net profit for a small business and I think that is just a little beyond the small business. What would you say would be his gross sales in a retail business?

Mr. Disher: I would say \$2 million to \$3 million.

Senator Isnor: Two to three million dollars. All right, Mr. Chairman, that is all.

The Acting Chairman: First of all, I would like to make the statement, professor, that I can assure you that those of use who are dealing with the subject matters in detail with our advisers will study very seriously a number of the technical suggestions that are contained in this brief. The mere fact that we are not detailed today does not mean they will not be dealt with seriously. What we are now attempting to do is to get to the hard core of some of these problems.

Professor Ilersic: Thank you.

The Acting Chairman: While we have you here from the west, we would like to put this question to you. Natural resources are giving us a great deal of concern from the point of view of (a) the tax holiday where it is applicable, (b) depletion, (c) companies who postpone their predevelopment expenses and do not include them by way of expense in the tax holiday years and (d) companies that strike bonanzas and really do not net the

benefits that are given to those. That, I think, gives us a composite overall picture of the problems.

Professor Ilersic: Yes.

The Acting Chairman: Would you give us the benefit of your thinking on that as to what we should do and may I say that, in the main, the extractive industries take the position that they are not being treated too fairly, that the incentive aspect of opening up the resources of our country call for it; that the commodities that they deal with, oil, ferrous and non-ferrous metals, are international commodities and that they have to deal with competitive conditions all over the world. That this is not a municipal, as an international lawyer would say, problem, et cetera. This is a law of the Medes and the Persians.

Professor Ilersic: May I start by saying that I am fully aware of the role which the resources industries play in the Canadian economy, at least in terms of their export earnings and the employment they have generated in particular areas of the western provinces and Ontario. Not least is the multiplier effects of such investments that develop opportunities for new areas to be opened up.

Quite clearly a large part of Canada's future gamble must still be based here on the resources industries. There is a great deal of talk about diversification of the Canadian economy but, on the whole, as long as the resources industries can continue to earn foreign exchange at the rate they now do I think the Canadian Government would be well advised to give them every encouragement.

Secondly, looking historically at the development of the resources industries, which have relied heavily on overseas capital, even if one wishes to be strongly nationalistic about this point, I believe the plain and simple fact of the matter is that Canada, its economy, people and, not least, the Department of National Revenue, have done damned well out of foreign capital. This point needs to be borne in mind.

The Carter Commission experts and the White Paper imply that in fact the resources industries have also done well at the expense of the Canadian taxpayers and that changes ought to be made. I would not dissent from this point of view, but I suggest that one needs to be a little more objective, rational and less theoretical about it.

The real point is this: suppose you impose a new tax structure such as the White Paper proposes—I am not suggesting for a moment that the tax proposals in the White Paper are all that unreasonable to the mining industry, I am not a spokesman for the mining industry; they are well capable of talking for themselves. However, I would say this, that your main hopes of opening up large parts of Canada, particularly the northern territories, must rely upon the willingness of the resource industries to there and almost certainly with foreign capital.

If I may just quote you, gentlemen, from *Perspective-1975*, which as you know is the Sixth Annual Review of the Economic Council of Canada, they refer to the future massive requirements in terms of capital:

These calculations imply that a very rapid growth in total savings will need to be achieved over the period 1967-75.

Further on they say that an unusually high rate of personal savings is required.

I am stressing here that the domestic economy of Canada needs foreign capital, despite the fact that the Canadian rate of savings in the private sector is one of the highest in the world at 18½ per cent, being exceeded by only one major country, Japan.

In the face of these simple facts, both current and historical, I would prefer to say let us leave well alone and hope that capital will continue to flow into the resource industries. We may have the odd bunch of sharks exploiting our tax laws in British Columbia, Alberta and the northern territories but, frankly, as long as they produce revenue for Ottawa at some future date or, more to the point, as long as they develop our resources and at the same time provide employment for our people—and God knows, in some of those areas employment is needed—I refuse, frankly, to get hot under the collar. Canada has bigger issues to face than the question of whether or not some of these people in the mining industry are fiddling a bit of tax.

The Acting Chairman: It would be pretty much the same as getting the odd bonanza company in relation to exempting some items of capital gains. That would be its introduction on the overall picture.

Professor Ilersic: One has to be practical about these issues. One of my criticisms of the White Paper is its extraordinarily theoretical approach in a desire to achieve what I would call fiscal perfection.

I have lived long enough in this world and am familiar enough with tax systems to realize that fiscal perfection, like perfection in a woman, is completely unattainable.

The Acting Chairman: Are you suggesting that perfection in a male is attainable?

Professor Ilersic: That I do not know, sir. According to my wife it is not.

The Acting Chairman: Are you suggesting that perfection in the male is attainable?

Professor Ilersic: Not according to my wife, sir.

Senator Cook: There is one point I should like you to develop, if you will, because I agree with it entirely, and it has not been made as clearly in other briefs as you have made it here. I refer you to page 4 of your summary where you say:

The White Paper appears to have been issued prematurely since...

(ii) The reader is left in some doubt as to the Government's views on capital cost allowances—a matter of fundamental importance.

I agree that it is a matter of fundamental importance. In other words, the Government can put the rates down and take away the benefit by putting down the capital cost allowances.

Professor Ilersic: With the greatest respect, Mr. Parkinson is more of an expert in this field than I am, and I subscribe to his view.

Mr. Parkinson: I think the comments in the summary of our brief pretty well express our views. It seems to us that depreciation deduction for business across the country is of such fundamental importance in assessing the acceptability of a tax structure that it was absolutely incredible to read in the White Paper that here is a brand new tax structure, or a completely new and revolutionary package, to be superimposed over an old structure, and that the country as a whole was being asked to assess the results of this and to indicate the acceptability or otherwise of it. Yet, tucked away in a small paragraph in the White Paper is the comment that the capital cost allowance structure will have to be looked at at some future time. As I say, the profit structure of many corporations is of such fundamental importance that it is incredible to think that somebody would say:

"Yes, this tax structure is acceptable," when a few months later the after-tax results may be totally different because of major changes in the capital cost allowances. I am not suggesting that the Government has indicated that they will diminish the capital cost allowance rates, but until that debate has been carried through, nobody knows.

Senator Cook: I have just one other point. A very small capital cost allowance could, for instance, in the case of industry, lead industry to retain obsolete machinery and all that sort of thing, which would put the industry in a non-competitive position vis-a-vis the United States or the United Kingdom, or any other country.

Mr. Parkinson: Yes, this is true. There is no doubt that the capital cost allowance structure of Canada during the last twenty years has been a major factor. It certainly has not been a major factor. It certainly has not been a deterrent at any rate to a modernization program.

The Acting Chairman: With technological developments particularly it becomes all the more important.

Mr. Parkinson: Yes.

Senator Cook: Yes. I am thinking of the pulp and paper industry.

Senator Burchill: I should like to ask the professor to comment on one point while he is here. What is his opinion on the integration of dividend credits, and what has happened in the United Kingdom? We have had two or three opinions on that, and we would like to have his.

Professor Ilersic: I will put it to you this way: If you would be good enough at your leisure—if you have leisure these days—to look at the news release from the Department of Finance dated March 6, and in particular at Table 15B-2, you will see there some extremely interesting figures showing the impact of the integration scheme upon the higher income earners.

The Acting Chairman: Are you speaking of England?

Professor Ilersic: No, I am speaking of Canada at the moment. I would like to introduce it in this way because it is relevant, if I may say so, with great respect. Fifty per cent of the total benefit here goes to taxpay-

ers whose incomes are in excess of \$10,000 a year, and the bulk of it to those with the higher incomes.

The importance of this can be judged only when you look at the fact that over 60 per cent of the capital gains tax proposal costs are charged to these income groups. In other words, integration is a fundamental part of the White Paper in relation to the capital gains proposals, which would otherwise be even more impossibly onerous than they are already.

As to the best method of taxing the shareholder or the company, this is a matter ultimately, if I may say so, of fiscal philosophy, on which I have heard your chairman discoursing earlier. Ultimately the question is what is the best way of ensuring that the tax falls on the shareholder at the progressive rates rather than that the corporate body retains those profits and thereby reduces tax. We in England, as you know, have our new corporation tax. Most of us, I think, would prefer to go back to the old system, where there was a straightforward credit for the tax paid. Admittedly, the private company, in particular, could try to avoid tax by withholding distributions, although the old section 21 managed to block this to a considerable extent. With the larger public company, the problem lies in the fact that, by retaining a high proportion of profits, companies generate capital gains for their shareholders. I am not sure that high retentions and capital gains are in fact closely correlated. American evidence does not suggest they are.

All I would say of the proposals in the White Paper for integration is that, regardless of whether they are a good method of dealing with the particular problem that the chairman has discussed, they are a fundamental part of the capital gains proposals. If one of these goes, then the other must go. They are extremely generous to the higher income groups, as they must be, simply because the capital gains tax provisions for the higher income groups are extremely onerous.

The Acting Chairman: They are extremely generous in the indication of what they would like to do. There is no indication that it will be so.

Professor Ilersic: What will happen. I agree, sir, these are yet unknown figures. These are on estimated distributions.

Senator Carter: Might I put just a general question? I see you are about to wind the meeting up. Assuming that the White Paper

proposals go into effect without any great modifications, have you given any thought or study to what the impact would be on a province, say the Province of British Columbia?

Professor Ilersic: I think this would require a statistical exercise which would involve so many assumptions that the end result, quite frankly, would be unrealistic. You see, what is so fascinating about the tax structure is that it is all pervasive; it affects every facet of life, from the individual's incentive to save and to earn to the corporate body's incentive to invest; it also affects foreign capital influx. There are so many imponderables that, with great respect, I do not think such an exercise is realistic.

All that I will say, if I may take the point just one stage further, is that if Canada does introduce these proposals, I am prepared to wager quite a substantial sum that you will never see a 50 per cent rate; and, what is more to the point, the hopes expressed this afternoon that this prospective surplus revenue, which was then referred to will never be returned to the taxpayers.

I do ask you, gentlemen, when you contemplate the tax structure of Canada, to look again at *Perspective-1975*, that is, the Economic Council of Canada's last report, in which it evaluates the future pressures on tax revenue. In particular I commend to you the February 1970 report of the Tax Structure Committee, which is really a frightening document. It really will bring you down to earth when you start to think about the prospects for tax remission.

The Acting Chairman: I would like to remind honourable senators that when we first examined Mr. Bryce at our first session and referred to the maximum 50 per cent tax rate, which is such an important structural part of the whole White Paper system, we asked him whether we could get some constitutional guarantees that would be binding on future ministers of finances. I do not know whether the answer is recorded, because I am not so sure whether smiles are recorded in stenographic notes.

Professor Ilersic: Exactly.

Mr. P. Walton, Vice-President, Taxation Committee, Vancouver Board of Trade: Mr. Chairman, I think there is one more quick point to be made on integration. A fact of integration which may not have been fully considered is that you may have a corpora-

tion in Ontario which has all its manufacturing in Ontario and all its payroll in Ontario; therefore the corporate tax it pays will go in part to the federal Government and in part to the Ontario government; roughly speaking, 40 per cent to the federal Government and 10 per cent to the Ontario government. If this corporation then has a major shareholder who is living and retired in Victoria, and is resident in Victoria in the last day of the year, in effect, because of integration, the individual shareholder will get either a refund of taxes or will pay less taxes as a result of the corporate taxes that have been paid in part to Ontario. Therefore, the Province of British Columbia will receive less taxes from the individual. In other words, there is a subtle shifting, or possible shifting, in terms of taxes, dependent upon where the

corporations are and where the individuals are.

The Acting Chairman: You are dramatizing what we said sometime today, and where I specifically referred to the sections of the White Paper which indicated that its implementation had to be worked out by agreement between the provinces, on a sensible basis; and that there was no such agreement as contemplated in section 1 and section 8 of the White Paper, that it is utterly impossible to implement the White Paper on an equitable basis.

Professor Ilersic: That is quite right.

The Acting Chairman: Thank you, gentlemen. Thank you, honourable senators.

The committee adjourned.

APPENDIX "A"

The White Paper - Proposals for Tax Reform

Brief submitted by
G. Arnold Hart
Chairman and Chief Executive Officer
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Introduction

The observations in the following pages on the proposals for tax reform contained in the White Paper which was released on November 7, 1969 are directed largely to their economic implications. Since I am not a tax expert I have made no attempt to analyze each of the many individual proposals in detail from the technical point of view. Furthermore, although I am a banker, my submission does not deal specifically with any of the tax proposals that might be considered to be of particular relevance to the operations of banks. It is my understanding that The Canadian Bankers' Association will be submitting a brief which I expect will deal adequately with matters of common interest to the chartered banks.

With regard to my own position as the Chief Executive Officer of a large bank with operations right across Canada as well as abroad, I can say that the only bearing this has on the nature of my submission is the fact that I am very conscious of the dependence of banks for their own growth and profitability on the healthy and dynamic growth of the

economy as a whole, which in turn is influenced very strongly by the tax regime. With this preamble, I should like to address myself first to the objectives of tax reform.

Goals for Tax Reform

I think there can be little disagreement in principle with the specific set of goals enumerated in Para. 1.6 of the White Paper, relating to fairness and ability to pay, economic growth and prosperity, social needs, voluntary compliance and the closing of loopholes, and acceptability to the provinces. The questions at issue are whether the measures proposed will be conducive to the attainment of these goals and whether, or to what extent, it is possible to achieve them all simultaneously. Indeed, this problem of reconciling apparently conflicting goals is recognized in the White Paper itself where, especially in Para. 1.10, each reference to an objective relating to such matters as growth and prosperity, incentives to work and invest, etc., is substantially qualified by the statement that the tax system should not interfere "seriously" or should interfere "as little as possible" with these goals and by the observation that some proposals are intended to ensure that incentives are not "unduly" inhibited.

I should have thought that the goal, whether

completely realizable or not, should be to promote or encourage such things as economic growth, incentives, etc. Where departure from this ideal seems unavoidable in the pursuit of some other goal, then the cost in terms of economic growth should surely be explicitly recognized in order that adjustments may be made in the rest of the system with a view to ensuring that interference with the economic objectives be kept to a minimum. In my own attempts to come to a balanced assessment of the extremely complex issues raised by the White Paper, I have tried to keep this criterion in mind.

The Proposals Viewed as a Set

Judged by this criterion, while some proposals in the White Paper are clearly worthy of support, others are not, and in my opinion the whole package taken together falls considerably short of what might reasonably be expected in the circumstances. This being said, I hasten to add that this does not necessarily mean that the whole set of proposals should be withdrawn, as has been suggested by some commentators. Nor does it mean that the shortcomings of the White Paper can be made good by minor amendments in detail to individual measures that have met with widespread criticism. It does mean, however, that a conscientious effort will have to be made to do a better job of reconciling the various objectives of a tax system than has been achieved in the White Paper proposals.

It also implies a willingness on the part of the government to give careful and serious consideration to views put forward in all sincerity by significant sectors of the community, not only about the mechanical aspects of some of the proposals but also, and more importantly, about the philosophy underlying them. This, in turn, involves a high degree of statesmanship in assessing the validity of the wide range of views being presented here and in resisting the temptation to score 'Brownie points' in a debate of great seriousness to the future of our country.

Members of the government have commented from time to time, rather sorrowfully, that much of the discussion of the White Paper has been critical and that little has been said about the merits of the proposals. I think this is an understandable phenomenon, partly because people do not often get very excited about things they do not disapprove of, but more importantly, because it may seem unnecessary to support those proposals which have been found largely unexceptionable and which obviously have the blessing of the authors. Nevertheless, the Committee may find it useful if I were at this stage to indicate in a general way those measures which I think are worthy of support, those which are desirable in principle even though the specific form could stand improvement, and those which, in my view, are either unacceptable

in principle or unworkable in practice.

Lest members of the Committee think that they are now going to be presented with a carefully selected list of objections to those proposals that would increase the tax burden on the rich or on special interest groups, coupled with token support for proposals designed to relieve the burden on those less well situated to pay, I say at the outset that I recognize fully that, given a particular revenue requirement, any change in the proposals that would have the effect of reducing the tax take must be accompanied by compensating proposals designed to pick up the lost revenue from another source. But I do not accept the necessity of restructuring the tax system in such a way as to capture larger revenues in relation to total national output than those produced by the present system.

- (a) I accept without reservation the fact that it is both necessary and desirable to find some economic means of lessening the tax burden on those of our people who are least able to bear it and commend the authors of the White Paper for their efforts to come up with a solution to this problem. I shall, however, make some suggestions for an alternative and less costly mechanism for achieving the same degree of relief for the people the proposals are designed to help.
- (b) With regard to the proposals for taxation of capital gains, after very carefully weighing the arguments for and against, both in principle and in relation to the special circumstances of Canada at the present stage of its development, on balance I am not opposed to some degree of taxation of realized capital gains, or to proceeding to institute it at

this time as part of the revised tax system. The specific set of proposals for bringing capital gains to tax does, however, in my view, need substantial modification. In particular, I consider the proposals to tax certain classes of unrealized gains totally unacceptable and I do not believe that realized gains should be taxed at full income rates.

- (c) I wholeheartedly support the move towards integration of corporate and personal income tax in order to avoid double taxation, while having reservations both about the particular mechanism chosen for achieving the objective and about the degree of integration envisaged.
- (d) While I recognize the validity of some of the arguments put forward in the White Paper about the present dual rate of corporate tax to the effect that it is open to abuse and also introduces anomalies in the tax treatment of small businesses, depending on whether they are incorporated or not, I think that further efforts to improve the present system should be made rather than to abolish an arrangement that has done much to encourage the establishment and growth of economically and socially useful small business.
- (e) I do not believe that it is desirable to attempt to make a distinction, for tax purposes, between closely-held and widely-held corporations.

The General Economic Implications

Having indicated in a general way my attitude to some of the principal proposals in the White Paper I think it might be useful, before elaborating my reasons for holding these views, to set out at this stage a summary of the economic effects that might follow, in my view, from implementation of the proposals in the form presented. In my considered opinion implementation of the total package would be prejudicial, in varying degrees, to the following:-

- (a) Savings, in both the personal and corporate sectors;
- (b) Incentives to work and to embark on risk-taking initiatives;
- (c) The development of small business;
- (d) The development of Canada's resource potential;
- (e) The prospects for the less-developed regions of the country;
- (f) The provision of adequate housing for Canadians and more specifically the development of home ownership.
- (g) The bond market and the ability of governments and institutions to obtain long-term financing at reasonable rates;
- (h) The maintenance of price stability;
- (i) Canada's international trade and balance of payments; and
- (j) More generally, economic growth.

These results will flow in part from the implementation of specific tax measures, in part from the redistribution of the tax burden and in part from the increased total tax burden which the new system is designed to impose.

The Total Tax Burden

There has been considerable discussion, both at the intergovernmental level and among experts, about the amount of revenue the new system will produce when it becomes fully effective and it would be pointless for me to enter into this particular numbers game, if only because the statistical base needed to make a judgment on the validity of these

estimates is not available to me. However, there is no disagreement about the fact that the proposed system is so designed that it will produce a substantial increase in revenues above and beyond those that would follow in the ordinary course from economic growth, and it is to this consideration that I should now like to turn my attention.

It is unfortunate that the proposals combine the revenue-increasing effect with the other objectives of tax reform. This makes it difficult for the observer to comment on the merits with respect to the latter without considering the former. While this is not the time or the place to discuss government spending policies and plans, some reference to this aspect of the question is unavoidable when faced with tax proposals which have as one of their expected results, expressed in quantitative terms, the capture by government of a larger share of gross national output, presumably to pay for an increased level of government spending on programmes as yet undelineated. Surely the electorate should be given the opportunity to consider such programmes on their merits and to judge whether they wish to pay for them by increased taxes or by reduced expenditures on existing programmes. To proceed otherwise is to cloud the issue of tax reform and bedevil the discussion of the tax proposals themselves.

However, we have no choice but to examine the proposals as presented, and these taken together involve a substantial addition to the already heavy total burden of taxation and a concomitant shift in resources from the private to the public sector of the economy. This in itself is cause for concern by those members of the community - and I believe they are the overwhelming majority - who still believe in, and attach importance to, private enterprise, private ownership and individual effort as the basis of a free and productive democratic society.

The Redistribution of the Tax Burden

This legitimate concern about the effects of an increasing total burden of taxation becomes even more acute when the tax system is restructured in such a way that a larger proportion of the increasing total will be borne by those on whom society as a whole must depend for the initiative and effort, for the savings and productive investment that are necessary for the dynamic growth of the total wealth of our country which, in the last analysis, is the only source for redistribution to those members and regions of our society in need of help. Improvement of the economic lot of the less affluent members of our society is certainly a desirable and necessary goal, and relief from the burden of taxation at the lower end of the income

scale is one possible means of approaching this objective. However, this relief will prove illusory if the total tax regime inhibits economic growth and private savings and contributes to inflationary tendencies.

Inflation

I would like at this point to say a word about the potentially inflationary consequences of the White Paper proposals. Several commentators, including myself, have expressed the view that the total package would tend to be inflationary for several reasons, including notably the effects, on both incentives and savings, of (a) higher marginal rates of taxation on personal incomes in the middle range of incomes, (b) a shift onto the middle income groups of a larger share of the total tax burden, and (c) the institution of a capital gains tax regime of the sort proposed. The simplified version of the argument is that any economic policy that encourages spending instead of savings is bound to be inflationary unless offset in some other way. As a generalization, I think this is incontestable and I also think that it is a somewhat less than positive contribution to the discussion to suggest, as the Minister is reported to have done,* that those who make such an observation are being less than fair to the poor. On the contrary, for those of us who, like myself,

*Speech to the Ottawa Chartered Accountants' Association reported in Globe & Mail December 18th and 19th, 1969.

support the basic social objective of raising the living standards of the poorer members of our society, the reason for drawing attention to the inflationary aspect of the planned shift in spending power is simply to point out that this effect must be recognized if proper care is to be taken in devising the rest of the tax package in such a way that the potentially inflationary effects are offset, or minimized, by gains in total productivity. This offset will surely not be achieved if incentives to individual effort and to productive investment are dulled and it is in this respect that the failure of the White Paper proposals to measure up to the ideal is most evident.

Savings

With respect to savings, I am astonished at the equanimity with which the authors of the White Paper view the reduction in aggregate private savings that may be expected to result from the proposals. The whole question is dismissed with the comment that the decline in private savings will be offset by an increase in public revenues and that these aggregate changes "could be taken into account in the determination of monetary and fiscal policy and could be offset in their general effects on total incomes, employment and prices". The implication that government in its wisdom can make at least as good judgments concerning the disposition of the extra resources available to them as the

private sector from which they are taken is surely a debatable point. Even if one could assume that the extra revenues would in a sense be saved - and the well known proclivity of governments on balance to spend at least as much as they have available in revenue does not lead one to be particularly sanguine in this respect - one is still left with a very large question mark about the relative economic value of savings invested through the public sector and those devoted to capital formation through private hands. Again we have the question whether Canadians should have the opportunity to express their will concerning the disposition of the resources they produce or whether they should be asked to surrender them in advance, with the decision left to government.

The rationale for this increase in taxation is said to be that it was necessary to devise a system that would not result in a diminution of revenues in the first year. But surely this could be achieved by some other means than by building in an unwanted growth factor. Many possibilities come to mind which may be grouped as follows:-

- (a) The schedule of rates, etc. could be set to produce the desired revenue (i.e., no increase compared with the present system which already, incidentally, has in it a surtax which was alleged to be temporary when it was introduced) at the end of the transitional period, with a downward-sliding scale of surcharges designed to keep the total constant, or

- (b) The benefits (increased exemptions, deductions, abatements, reduced rates, etc.) could be phased in over time.

The Personal Income Tax System

While there has been, to my knowledge, no serious objection from anyone concerning the intention to relieve or lessen the burden on lower income taxpayers, a great deal has been said about the high cost to the revenue of raising the basic exemptions, not only for this group but for all taxpayers. It has already been noted by spokesmen for the government that only about \$35 million of the revenue foregone will benefit the lowest income groups, whereas the total revenue cost of raising the basic exemptions is estimated at about \$1 billion. This result flows, of course, from both the large number of people and the fact that, given the existence of a progressive income tax schedule, the benefit to the taxpayer (that is, the cost to the revenue) of exemptions rises more than proportionately as income rises. It is surely an anomaly that a benefit system which is ostensibly based on welfare considerations should have the following results:-

- (a) The higher up the income scale you go the greater the benefit of a given exemption, and
- (b) The higher up the income scale you are the greater the benefit to be derived from an increase in the number of dependants.

Of course, it is possible to offset the regressive effect noted in (a) by making the whole schedule more progressive and this is what has been done in the White Paper. However, this does not remove the anomaly inherent in the fact that a person with an above-average number of dependants gets proportionately greater benefits from the taxation system the higher his income is.

The overall effect of measures to recoup this large volume of lost revenue is, of course, to compress the gradations of the tax scale into a narrow band and also to discriminate against people with a below-average number of dependants by making the tax schedule even more progressive for them.

In my view a much more rational system would be one based on tax credits where a fixed dollar amount of credit is given, after calculation of tax, for each dependant qualifying for an exemption under the present system. The revenue costs per exemption would, therefore, not rise as you proceed upwards through income groups and it would be possible for the tax authorities to estimate with some accuracy what the cost of a change in the credits would be, without making complex calculations and judgments about the changes in the whole structure of rates that are necessary under the present system. Thus, an orderly system of

adjustments of credits as economic circumstances change would be facilitated. Under the present system people move out of the tax exempt brackets merely by the process of inflation and are therefore doubly penalized.

Of course, other things being equal, the effect of such a change to a tax credit system would be to increase the progressivity of the schedule for taxpayers now entitled to exemptions, and certain other side effects would have to be considered. Some of these apparently anomalous effects were pointed out in a paper made available to the general public under a Department of Finance press release dated March 6th. However, it seems to me that the paper presented at that time did not do justice to the tax credit proposal in two major respects.

- (a) It made a comparison between a tax credit system and an exemption system on the assumption that the rate schedule proposed in the White Paper would nevertheless be brought into effect even if tax credits were substituted for exemptions. This, of course, would not be the intention but rather that, given the lower cost of providing an equal absolute amount of tax relief to all taxpayers, regardless of income, for each entitlement to an exemption, the whole structure of rates could be made less progressive on average than in the White Paper, (while presumably being more progressive than it is now - but this need not necessarily follow when the revenue effects of taxing capital gains are taken into account).
- (b) As a result of applying the same schedule uniformly to taxpayers with dependants and those without, the paper suggested that a tax credit system would discriminate against those with dependants. However, this need not be

the case for it is surely not beyond the ingenuity of man to devise a system of schedules such that the incidence of taxation on the margin would be the same for all taxpayers with a given level of income. All that is needed, as I understand it, when using a tax credit instead of an exemption, is to shift the whole schedule upwards for people with less than the average number of dependants and downwards for taxpayers with more than the average number of dependants.

I urge the Committee to give further consideration to this question of tax credits before developing its recommendations to the government. There are many possible variants to the proposal, some of which would combine tax credits and exemptions. For instance, it is perhaps arguable - and I have no strong views one way or the other on this - that employment expenses should be handled by way of deductions in order to ensure that the benefit rises as income rises, presumably on the grounds that the expenses themselves rise with rising incomes. This argument could even be extended to the basic exemption for every taxpayer if this were considered as equivalent to an employment expense. However, I can see no rationale for having exemptions for dependants - which are predicated on what amounts to welfare grounds - result in higher tax benefits the higher the ability to pay.

Reverting again to the question of the structure of the personal income tax, it is a truism that the burden of tax resulting from giving relief to any one group has to be borne by some other group and, as the White Paper rightly

points out, the broadly based middle income groups are the only ones with enough taxable income in total to make up for the revenue lost lower in the scale. But every means should be explored to avoid an excessively progressive system within a narrow band of incomes and it seems to me that the tax credit system offers one such possibility. Another would be to have the 50% rate reached at a somewhat higher income level than the \$24,000 proposed in the White Paper and to let the top rate rise somewhat higher than the proposed 50%. The White Paper is, of course, absolutely right in its contention that the top marginal rate should not be higher than about 50% if capital gains are to be taxed at full income rates. However, if, as I shall suggest in the next section, capital gains were to be taxed at lower rates, this consideration would not apply to the same degree.

Taxation of Capital Gains

Without for the moment expressing a view about the specific proposals in the White Paper for taxing capital gains, I think it is worth pointing out that the effect will be not only to shift even more of the tax burden onto the weary shoulders of the middle income groups but also, in the process, to put a very large number of them into a position where the higher or highest marginal tax rates apply.

On the former point some evidence is available.

Recent estimates from the United States suggest that a large proportion of gains realized accrue to people whose incomes are relatively modest. The tables distributed under the March 6th press release from the Department of Finance indicate that the same is likely to be the case in Canada, since only about one-third of the expected revenue from taxation of capital gains in the fifth year of the plan is attributed to taxpayers with incomes over \$25,000.

No evidence in support of the second point is readily available but it does seem reasonable to assume that, since the Department's revenue expectations from capital gains are heavily weighted in the \$10,000 - \$25,000 income classes, relatively large numbers of taxpayers in those groups will be faced with a sharply rising marginal tax rate up to the proposed maximum.

The combined effects of a heavier tax burden and higher marginal rates cannot help having an undesirable effect on incentives in a group which includes a very high proportion of the skilled managerial and professional people on whom the country must depend in no small measure for progress on many fronts. It is in these groups too that one would expect to find the greatest sensitivity to international differentials in personal taxation and I would not wish to think that Canadians should have to rely on the kind of non-economic factors alluded to in Para. 8.38 of the White Paper

to keep our people here in spite of the widening differentials.

On the actual question of taxing capital gains, I have done much soul-searching. On the one hand, I think there is no denying the argument that taxation of capital gains at more than nominal rates must have a deterrent effect on risk-taking and on various kinds of economically useful and productive initiatives. I also fully appreciate the force of the arguments that have been advanced for years concerning Canada's shortage of capital relative to its development needs and concerning the need for caution in instituting any measures that would tend to discourage either the inflow of development capital from abroad or the useful application to growth-oriented endeavours of internally generated capital.

On the other hand, I recognize that the present system under which certain classes of capital gains escape tax entirely - although the numbers of these situations have been progressively reduced over the years as the revenue authorities have become more astute - is either unfair or gives the appearance of being unfair. I also recognize that a system which allows people in certain circumstances to avoid tax completely by arranging to realize capital gains may lead to misallocation of resources and to undesirable distortions in the economy as a whole.

On balance, I have come to the conclusion that the disadvantages of the present system may well outweigh the advantages and that the time has come to consider the institution of a capital gains tax that would help to reduce the disadvantages of our present arrangements without completely removing the advantages. Regretfully, the White Paper proposals in this connection do not meet the test.

In the first place, I do not concur in the view expressed in the White Paper that all incentives should be removed for the realization of capital gains instead of income. This would be the result if capital gains were to be taxed at full income rates and if, in the case of shares in widely-held corporations, a half-gains rule were instituted to parallel half-integration of the income of such corporations and their shareholders. I am convinced that some significant incentive to embark on risk-taking ventures must remain if we are to have the kind of dynamic economy and society that we need for growth.

In the second place, I do not believe, as the authors of the White Paper apparently believe, that Canada can safely have a capital gains regime significantly more onerous than, or even as onerous as, that which is in effect in the United States.

In the third place, I do not consider that there should be taxation of unrealized capital gains in any form

during a person's lifetime. Enough has been said in the past few months about the inherent injustices of the proposal for periodic revaluation of, and taxation of the deemed gains on, shares of widely-held companies and about the difficulties such a proposal would present for the maintenance of control of both widely-held and closely-held corporations that I need not repeat the arguments here. I have read carefully the summary of suggested modifications to the proposal that was made public by the Minister on March 10th, but I feel compelled to say that, with all due respect to the authors of the various suggestions, the best suggestion of all is simply to drop the proposal. I have also read with interest the Minister's summary of the difficulties he would face if the proposal were dropped but again, with respect, do not see how they can reasonably be considered insurmountable.

The other proposal for taxation of unrealized capital gains - that is, on leaving the country - is also, in my view, completely unacceptable. Many of the problems this would raise are similar to those relating to periodic revaluation of shares of widely-held corporations and, in addition, it would cause serious difficulties for employees of corporations or institutions with international operations, and for their employers, in connection with transfers in and out of the country. Similar difficulties would arise for

self-employed people who wish to go abroad for experience, education or any other reason where they are not definitely severing all connection with Canada. The suggestion has been made that the proposal be modified to exempt departing residents where their intention is to be abroad only temporarily, subject to the posting of some suitable bond to cover their potential tax liability, but this would pose so many administrative and other problems that I think it would be best to tax only gains realized on the sale of assets.

In the fourth place, particularly in view of the Minister's repeated assertion that it is not the intention to raise any significant revenues from taxation of gains on the sale of personal residences, I think that proposal should be dropped as well. Various suggestions have been made for modifying it by, for example, raising the tax-free limit on gains allowable for each year of residence but these would open up as many new problems as they would solve. The amount necessary to take care of the rise in house prices in a particular area of the country may be so much in excess of that applicable in another area that the inequities that are alleged to exist in the present situation would largely remain. In any event, it seems to me that the numbers of people who will try to make a fast buck tax-free by an occasional bit of house-hopping are likely to be so small, given the inconveniences involved, that it is not really

worth the trouble and expense for all other homeowners that would be affected by the White Paper proposal to try to catch them. It can also be argued, I think, that such people may on balance perform a useful social function in upgrading the housing stock.

Similar considerations apply to the proposal to tax gains on certain classes of personal property. While recognizing the potentiality for tax avoidance that exists in investment in such goods if the gains are not taxable, I do not think that throwing the net wide to catch all the little fish in the country will really solve the problem if it in fact exists to any appreciable extent beyond the limits of existing provisions for dealing with people who are in the business, or make a habit, of buying and selling such goods.

All things considered, therefore, I think the proposals concerning taxation of capital gains should be substantially modified. The rate of tax on realized gains should be no higher than half the rates applicable to income, up to a maximum of 25%. For this purpose capital gains should be defined to exclude returns from the turnover of assets held less than six months, which should be taxed at full income rates. There should be no taxation of unrealized gains during an individual's lifetime and there should be no taxation of gains on sale of personal property or of principal residences. At the same time, if a capital gains

tax is instituted there would clearly be a need to make some modifications in the existing regime for taxation of estates and gifts, both to avoid punitive or confiscatory taxation and to deal with the treatment of accrued gains in an equitable manner.

Integration of Personal and Corporate Income

The White Paper proposals for achieving a degree of relief from economic double taxation, as between corporations and their shareholders, have much to commend them and the move in this direction has been widely acclaimed. However, the particular mechanism outlined in the White Paper for achieving this end is rather cumbersome and it has become increasingly clear that its implementation will raise a multitude of side problems, particularly where international income is involved. In consequence, many alternative suggestions have been put forward, by others more expert in tax matters than I am, as a replacement for the proposed grossing up of dividends - tax credit mechanism suggested in the White Paper. The alternative that seems to have the widest support is the dividend deductible mechanism, where dividends would be a deductible expense for the corporation and would be fully taxable in the hands of the shareholders. One would assume, naturally, that the dividend payout would under this system be correspondingly higher. This proposal seems eminently sensible to me and I recommend that the Committee give favourable consideration

to briefs that come forward from experts in this area.

Closely-held and Widely-held

In a related connection I find that I am unable to agree with the reasons set out in the White Paper for making a distinction for tax purposes between classes of corporations which have been described as closely-held and widely-held. The proposed dividing line is really quite arbitrary and it is clear that a dual regime of this sort would result in a whole range of discriminatory incentives and disincentives, some intended, some not, in relation to certain kinds of investment. Again I would not wish to take up the Committee's time by reciting the many anomalies that would arise, since they have already been well documented by others. I simply want to add my voice to those who have recommended that the rules concerning taxation of corporations and the flow of income from corporations to shareholders be uniform.

Small Business

Of all the proposed changes in the White Paper I doubt that there is any that has been more hotly and seriously debated than the one to abolish the split rate of corporate tax whereby the first \$35,000 of corporate income is taxed at a lower rate. There are perhaps as many supporters of the White Paper point of view as of the maintenance of the present system but I think it is worth noting that

the opposing sides in general have one objective in common. Most people feel that small business performs a useful, indeed, essential social and economic role in a country such as ours and that some mechanism should exist for encouraging the establishment and continuation of new small businesses and for encouraging them to grow, where growth is desirable. Of all the arguments in favour of the encouragement of small business I think I would attach most importance to the one that relates to the development of entrepreneurship, which is so essential for the dynamic development of our economy.

I recognize that the present system, which was introduced about 20 years ago after careful consideration by a Royal Commission and by parliament, has opened up several possibilities for abuse, but these have been brought progressively under control and I am confident that further progress could be made in this direction. I recognize also that the tax benefit available to small incorporated business is not available to the much larger number of small unincorporated businesses, but it would not seem to be a progressive step to abolish an arrangement that has served a useful purpose for one segment of the business community just because it is not readily available to another.

A great variety of alternative proposals have

been put forward, either for the temporary encouragement of small incorporated business or for the encouragement of deserving small business, incorporated or not. Many of the former, such as withdrawing the low rate of tax after a business has achieved a certain cumulative level of profits would, it seems to me, be open to the same kinds of abuse that are possible in the present system, so nothing would be gained on that score. Many of the latter would involve an extension of the discretionary powers of the government and I think that the Committee would want to satisfy itself in examining these that they would not be giving their blessing to schemes which would allow the dull hand of bureaucracy to play an increasing role in an area which almost by definition depends for its success on individual effort and enterprise.

In all the circumstances, I think it would be unwise to do away with the present arrangements at this time, particularly since we do not have the benefit of the government's views on what it proposes as an alternative.

The Resource Industries and Foreign Ownership

Many aspects of the White Paper are particularly difficult to come to grips with because of the lack of an agreed policy framework within which to judge them. The question of an increased aggregate level of taxation, which I have already dealt with, is one of these.

A similar problem relates to the effects of the White Paper proposals on certain categories of industry - for example, the extractive industries. I would not wish to put myself in the position of arguing the case for or against any particular industry. Their own spokesmen are quite capable of making their positions clear, and members of the Committee are certainly capable of assessing the validity of the arguments advanced by them. There is, however, a question of the national policy framework within which these matters should be judged and where this is unclear the task of putting the arguments into the right perspective is doubly difficult.

For example, there has been a lively debate for many years on the question of foreign ownership and control of Canadian industry and also about the relative importance to be attached to resource development and to the promotion of other sectors of the economy. There has also been a series of ad hoc decisions relating to the degree of foreign ownership of particular classes of industry. However, it cannot be said that there exists a clearly articulated policy, on which the electorate has had an opportunity to express its views, to the effect that foreign investment in Canada should be inhibited or that investment, by Canadians or others, in the exploration for and development of Canadian mineral resources should be discouraged. Indeed, the White Paper itself does not set these out as specific objectives

of tax policy.

And yet qualified spokesmen for the industries concerned have stated that this would be the general direction in which Canada would move with the adoption of the White Paper proposals - not only those that relate specifically to the extractive industries, but also their interaction with the whole complex of measures dealing with the taxation of business and property income, the differentiation between closely-held and widely-held corporations and the institution of the particular capital gains tax regime advocated. If the industry spokesmen are right in their judgment of how the proposals would affect them, the cost to Canada in terms of economic growth, employment, standard of living, and so on would be very great indeed. The Canadian people should, in my view, be made aware of these costs before being asked to render judgment on a set of proposals which, masquerading under the title "tax reform", would have these results.

The Regional Impact

Other problems of a similar nature come to mind in relation to the regional impact of the changes proposed in the tax system. One of the corollaries of shifting the tax burden from individuals with lower-than-average incomes to individuals with above-average incomes is that the provinces where personal incomes are below the national average will lose revenue, except in so far as this effect is offset

by the workings of the equalization payments mechanism. At the same time if, as is generally recognized, the proposed changes would have the effect of suppressing activity in the resource-development field it is the relatively slow-growth areas of the country that will feel the effects most strongly. Furthermore, if the proposal to abolish the split rate of corporation tax does in fact inhibit the establishment and development of small business, the foundation for future economic development of the currently under-developed regions of the country will be undermined.

It may be argued that all of these potentially depressing effects on economic growth in the less developed regions of the country could be offset by a suitably devised regionally differentiated scheme for the promotion of new industries. But if this is the intention - and even if one were to accept the implied additional intrusion of governmental discretion into the decision-making process concerning investment - is it safe to assume that there is an agreed national policy that the balance of power in relation to regional economic development policies should be shifted towards Ottawa in this way? Clearly the answer to this question is not an unqualified yes.

The Effect on Interest Rates and the Balance of Payments

One of the more difficult questions to assess is

the possible effects of the White Paper proposals on the structure of interest rates. Not enough is known about financial flows to subject this question to a truly rigorous analysis but I find it difficult to be convinced that upward pressures will not be exerted on interest rates, particularly if the measures proposed in the White Paper have the effects the authorities attribute to them.

In the first place aggregate savings in the private sector are expected to be reduced. This reduction in the supply of savings would in itself work in the direction of higher interest rates. Furthermore, within the smaller total, the White Paper proposals are designed to provide "a powerful incentive for equity investment by Canadians in Canadian corporations". This may indeed be a desirable result but it should be recognized that, other things being equal, this must reduce the amount of domestic savings available for investment in bonds and other fixed interest securities and mortgages. Add to this the potentially inflationary effects of the White Paper proposals as a whole and it seems to me that you have a powerful confluence of forces working in the direction of higher interest rates.

These effects could in theory be offset by appropriate monetary and fiscal policies. I say in theory, because the Canadian economy is not a closed system and it

would appear that the combined effects of the White Paper proposals on our external accounts would be such that, in fact, an even wider differential between Canadian and external interest rates than at present would be required to maintain the necessary balance between the current account and the capital account at a given rate of exchange. The argument runs as follows.

If the White Paper is inflationary Canada's international competitive position in general will be impaired. If at the same time resource development in Canada is inhibited relative to other forms of investment, exports of resource products in particular will be depressed. Similarly, if Canadian direct investment abroad is discouraged the development of related markets abroad for Canadian products will be discouraged. Furthermore, if foreign ownership of Canadian resource industries is suppressed or inhibited tied markets for resources may decline in relative importance.

All of these effects are in the direction of suppressing Canadian earnings from foreign trade and the only ready offset on the current account side that comes to mind is a decline in import requirements for investment programmes, assuming that the White Paper proposals do in fact inhibit growth - surely not a very desirable offset. On the capital side of the accounts, there will be several cross-currents the effects of which are rather difficult to add up. However, since the White Paper proposals will, by

the authors' own admission, result in a relative decline in the availability of private domestic savings for investment it follows that, for a given level of capital formation in real terms to be achieved, a greater reliance will have to be placed on foreign sources of supply. The total thrust of the White Paper proposals would seem to suggest, therefore, that relatively higher interest rates in Canada will be required to attract the necessary in-flow, and it would not seem to be feasible, given a particular growth objective for Canada, to adopt monetary and fiscal policies designed to offset the upward pressure on interest rates that will flow from the White Paper proposals themselves.

The consequences of such a tendency to higher interest rates are many and varied but they include the following. Servicing of external debt would become more and more onerous if a higher proportion of foreign capital inflows takes the form of investment in fixed interest securities. Over time this result could be reinforced by the depressing effects on foreign source income of Canadians as a whole resulting from the various inhibitions on Canadian investment abroad that are contained in the White Paper. The cost of borrowing will go up for governments and institutions which rely on debt financing. And last, but not least, higher interest rates would give another twist to the screw of higher costs of housing and place home ownership further

beyond the economic capabilities of many Canadians.

Concluding Remarks

In the foregoing pages I have indicated some of the factors that led me to comment early last December, in an address to the shareholders of the Bank of Montreal, that what was being proposed in the White Paper would effect radical changes in the economic, financial and social structure of Canada. I have not changed this overall view and I think some of the basic considerations I have raised in this submission transcend in importance the measures themselves. However, there is much that is useful in the White Paper and I am convinced that with good will and a responsive exchange of views between the government and the community it should still be possible to build upon that base to construct the kind of tax system that will permit a realistic harmonization of the economic and social aspirations of the Canadian people.

Montreal, P.Q.
March 23, 1970

G. Arnold Hart

The White Paper - Proposals for Tax Reform

SUMMARY OF BRIEF

submitted by

G. Arnold Hart
Chairman and Chief Executive Officer
Bank of Montreal

1. There can be little disagreement in principle with the goals outlined in the White Paper. The question is whether the measures proposed are conducive to the attainment of these goals or whether it is even possible to achieve them all simultaneously.
2. While some proposals in the White Paper are clearly worthy of support, others are not. Further consideration should be given not only to the mechanics but also to the philosophy behind the White Paper proposals.
3. Of key importance is the fact that the White Paper would result in a substantial increase in total revenues so that many of the calculations concerning redistribution of the tax burden are misleading or meaningless. Furthermore, the shift of resources from the private to the public sector is a matter which should be settled by the electorate in another context, not presented in the guise of a tax reform measure.
4. Improving the living standards of the poorer members of our society is certainly a desirable and necessary goal and there can be no objection to relieving the lower income people of the burden of taxation. However, relief will prove illusory if the total tax regime inhibits economic growth and savings and contributes to inflationary tendencies.
5. Any change resulting in a shift from saving to spending is inflationary. An attempt should be made to offset the potentially inflationary effects of a redistribution of the tax burden by devising the rest of the tax package in such a way as to provide offsetting gains in total productivity.
6. Productivity gains will not be forthcoming if incentives to individual effort and productive investment are dulled.

7. Use of the exemption mechanism to achieve a shift in the tax burden is costly and cumbersome. One based on tax credits may be preferable.
8. The combined effects of higher marginal rates and the relatively heavy incidence of capital gains tax cannot help having an undesirable effect on incentives for the middle-income groups.
9. With regard to the taxation of capital gains, it is possible that the disadvantages of the present system, of no gains tax, may well outweigh the advantages. However, the White Paper proposals have serious shortcomings. In particular, from the point of view of encouraging economically desirable risk-taking, it would not seem wise to remove all incentives to achieve capital gains. The rate of tax on realized gains should be lower than suggested, and the proposals to tax unrealized capital gains and the gains on the sale of personal residences and other types of personal property should be dropped.
10. The proposals designed to eliminate or reduce double taxation of corporate profits have much to commend them. A simpler mechanism would be the treatment of dividends as a deductible expense at the corporate level, and fully taxable in the hands of recipients.
11. The distinction between closely-held and widely-held corporations is arbitrary and would result in distortions between certain kinds of investments.
12. Small business performs an essential social and economic role and, rather than eliminate the encouragement provided by the present split rate of corporate tax whereby the first \$35,000 of corporate income is taxed at a lower rate, efforts should be made to reduce further the possibility of abuse in the existing framework.
13. The lack of a national policy framework makes it difficult to judge the effects of the White Paper proposals on certain categories of industry. Qualified spokesmen have stated that the proposals would inhibit the development of Canadian mineral resources. The Canadian people should be made aware of the economic costs involved in taking this step before being asked to render judgment.

14. To the extent that the proposed system adversely affects resource industries and small business, economic development of the currently under-developed regions of the country will be especially hard hit. While this could be offset by a regionally differentiated scheme to provide incentives to new industries, this would result in a concomitant centralization of the decision-making process regarding new investment.
15. While it is difficult to assess the possible effects of the White Paper on the structure of interest rates, it would seem that upward pressures would be exerted.

APPENDIX "B"

Submission to
The Standing Senate Committee
on
Banking, Trade and Commerce
on
Proposals for Tax Reform

by :
The Canadian Institute of Chartered Accountants

Standing Senate Committee

The Canadian Institute of Chartered Accountants
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COMMENTS ON PROPOSALS FOR TAX REFORM
MADE TO
STANDING SENATE COMMITTEE
ON
BANKING, TRADE AND COMMERCE

JUNE 1970

TAXATION COMMITTEE

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W.K. McIntyre - Secretary

The Canadian Institute of Chartered Accountants
L'Institut Canadien des Comptables Agréés

SUMMARY OF CONCLUSIONS

In making this submission, we have drawn on the professional expertise of our members, and have endeavoured to provide useful comment on the broad range of Proposals in the White Paper. It is not practical or feasible to include all of our recommendations and suggestions in this summary, and accordingly we have confined it to our major points. Many of the more specialized and technical recommendations are not included in this summary but merit serious consideration in the structure of a new tax system. For ease of reference, our submission is structured along similar lines to those of the Proposals for Tax Reform.

Chapter A - General

We support the need for a reduction in taxes to the lower income groups, and we recognize the necessity for a widened tax base and some reform of our existing tax rules. We are, however, concerned if this shift in tax burdens results in such a reduction in incentives and savings that it causes a reduction in the rate of economic growth, with deleterious effects on all Canadians regardless of their circumstances.

There have been various estimates concerning the increase in taxes which will occur if the White Paper Proposals are enacted; while we are not in a position to comment upon the validity of these estimates, the need for an increase of the magnitude suggested by even those estimates in the White Paper has not been justified and we suggest that the tax changes actually implemented should be designed to raise revenues equivalent to the present system.

We believe that the introduction of any large part of the recommendations contained in the Proposals will place a much heavier burden upon the Department of National Revenue, and regret that no Proposals were made pertaining to its administration.

Chapter B - Individual and Family

We foresee problems and inequities in the Proposal that top rates of tax be reduced to 50% over a four-year period beginning in the second year of the new system. This suggestion is particularly disturbing because of the magnitude of the tax on capital gains which will result in the interim period. Taxpayers will generally endeavour to defer realizing income or gains during this transitional period, but in some cases will be unable to do so. In our opinion the tax rates will be unrealistically high

in the transitional period and should be reduced immediately on implementation of the new system.

We believe that as the new system matures, the tax burden on middle income Canadians should be reduced; this can be accomplished by extending the progressive rate schedule so that the maximum rate of personal income tax is reached at the \$50,000 to \$100,000 range of income. These middle income taxpayers are usually those with the special education and skills which our country needs, and we believe their rates of tax could be closer to those of other countries with which we compete for skilled and innovative personnel.

We endorse some broadening of the income base by including items not now taxed such as scholarships but regret the omission of strike pay. Such broadening should, however, be accompanied by reasonable transitional measures and a more effective averaging system than that contained in the White Paper.

Chapter C - Capital Gains

We are unable to support a tax on capital gains which provides for the full inclusion of long-term gains in income. Such treatment makes no allowance for the effects of inflation, the length of holding, the differences from ordinary income, the limited averaging proposed, the desirability of incentives to own certain investments and the motivation to accumulate capital. We have considered the various types of capital gains separately.

We recommend, as a general rule, that for capital assets (except for those for which special treatment is recommended following) any gains be included in income in full unless the asset has been held for a period in excess of (say) three years. If it is held longer than that, a reducing percentage of the gain should be included in income. The deductions should be so scaled that the percentage included in income will drop to a minimum of 50% if the asset has been held for (say) thirteen years. This rule would apply to gains (and losses) on assets such as land and shares of foreign companies.

We recommend that gains on shares on Canadian corporations, regardless of the holding period, be included in income to the extent of 50%, to provide an incentive to Canadians to make this type of investment.

Both gains and losses on bonds, mortgages and agreements for sale should be fully included in income as they are, in essence, the result of a taxpayer choosing to realize his interest in a different form.

Where there has been a forced realization, such as expropriation or destruction of the asset, or on death, only half the gain would be included in income regardless of the actual holding period. This general approach provides relief for illusory gains as a result of inflation and avoids sharp distinctions in

tax rates based upon minor differences in the length of the holding period.

To prevent a taxpayer from deducting losses and deferring gains, we suggest some limitations on the deductibility of losses realized on shares. Realized capital losses should be deductible against capital gains in the same year; the excess of capital losses over capital gains realized in any year be deductible against other income to the extent of \$2,000; and further losses be deductible against any net capital gains realized in the immediately preceding year. Realized losses not deductible under the preceding recommendations would be deductible against any future net capital gains without time limitation or, if a loss has been sustained in excess of the \$2,000 limit, the taxpayer be permitted to revalue to market all shares owned by him and deduct any resultant net loss from any other type of income. Losses on other investment assets should be deductible immediately.

We agree that normal gains on homes should not be taxed and therefore strongly recommend that a more generous allowance be introduced, \$2,000 per year of occupancy and \$200 per year for improvements, appears more appropriate. Any further gains realized should be subject to reduced inclusion in income based on the holding period outlined. To eliminate record keeping for many homeowners, we suggest an assumed minimum cost of \$25,000. We also recommend that a "roll-over" be permitted on the re-investment within a limited time period, of the proceeds of sale of one residence in another, regardless of the reason for the change, so that the country's housing is efficiently used.

If our recommendation for the immediate elimination of higher marginal tax rates is not accepted, we believe that capital gains realized during the transitional period should be taxed at a rate no higher than 50% of the gain. Also, we cannot endorse a capital gains tax of the magnitude suggested without a substantial adjustment of estate and gift taxes, and we therefore strongly recommend that on the introduction of the tax on capital gains, the minimum exemption for estate tax should be increased to the order of \$200,000 with the rates ranging from about 15% to a maximum of 35% where the estate value exceeds (say) \$2,000,000.

Chapter D - Corporations and their Shareholders

We are unable to accept the line of distinction drawn in the White Paper between widely-held corporations and closely-held corporations. Although this distinction may be valid in extreme cases, we believe there is a gradual transition from one to the other and most corporations probably fall somewhere between the extremes. The substantial difference in tax burden that could result for shareholders of essentially similar types of corporations is not justified.

We therefore believe that all corporations should be treated in the same manner. We find the Proposal for complete

integration of all corporate income with personal income conceptually attractive but we are unable to recommend it this time because we are neither convinced that shareholders do, in fact, bear the total burden of corporate tax nor are we satisfied that this added degree of incentive is appropriate or financially feasible at this time. We therefore suggest that all corporations be treated in the manner proposed for widely-held corporations. This means that on dividends received from all Canadian companies, shareholders would obtain credit for one-half of corporate tax paid and would correspondingly include one-half of Canadian share gains in their income. We are generally prepared to accept the integration Proposals (relating to widely-held companies) suggested in the White Paper, but only with substantial modifications to ease the tax burden on dividends paid out of earnings not covered by creditable tax and to facilitate the free flow of inter-corporate dividends. The integration Proposals as they stand would create massive inequities and problems, but we believe that they can be modified to provide a workable corporate environment as well as incentives for Canadian investors.

We appreciate the force of the Government's argument for withdrawal of the low rate of corporate tax but believe that some form of assistance is required for new small business because of the difficulties which these firms experience in raising funds for growth and expansion. Small business plays an extremely important part in the Canadian economy and the burden of tax they would bear under our recommendation that all corporations be treated as widely-held would appear inappropriate, particularly in their early years. We endorse the partnership option which is proposed in the White Paper but think this is quite inadequate by itself. Some small corporations that require assistance will be unable to make this election. We have therefore set out a number of alternative suggestions, each of which provides the needed assistance by deferral of taxes rather than an outright reduction of rates as we believe that the assistance provided should be to the corporations and not their shareholders.

We are opposed to the five-year re-valuation of shares of Canadian companies as it can result in taxes being paid on market gains which in fact may never be realized. It can have unfortunate effects upon owners of controlling blocks of shares because of the need to sell shares to pay the tax. We have therefore recommended what we believe to be the only feasible alternative, this is, that taxes on capital gains should only be paid at the time they are realized and that there be a deemed realization on death. We recognize that this recommendation could result in deferral of tax and accordingly we have made suggestions which we believe will equitably protect both taxpayers and the revenue.

Chapter E - Business and Property Income

We welcome the Proposal to permit amortization of certain

capital outlays (the so-called "nothings") which taxpayers have been unable to deduct previously, but we are opposed to the inclusion of goodwill in this category. We do not think this treatment is appropriate for goodwill and although the Proposal would include an increasing portion of the sale proceeds of goodwill in income, it provides no deduction for the value of goodwill in existence at the start of the system. There are many business situations which by contract call for the adjustment of goodwill on an almost annual basis and adjustment of present contracts and arrangements would be onerous and could result in inequities. We suggest that goodwill should not be depreciated but that realized gains should be taxed and realized losses deducted.

We are concerned about the proposed cut-back in resource incentives, and suggest a re-examination of these Proposals to ensure that the Canadian resource industry will be provided with a tax system that will allow it to remain competitive.

We suggest that while some limitation on depreciation deductions on rental properties is valid, the Proposals in this area will require significant modification.

We support the Proposal to deny deductions of unreasonable entertainment expenses, yachts, wives' travel and unsubstantiated expenses, but our beliefs are equally strong that properly substantiated and reasonable entertainment costs (including membership in clubs used for business purposes) should continue to be deductible, as well as the cost of attending business or professional conventions and meetings, which have a substantive technical programme.

Chapter F - International Income

The White Paper proposes some highly complex and major revisions to the taxation of international income flows to and from Canada. Many of these have considerable merit and others, we believe require amendment.

We would be greatly concerned if any of the Proposals were to hinder either Canada's considerable export market which is such an important cornerstone to the country's economy or the inflow of foreign capital which has contributed so substantially to the country's economic growth. The White Paper appears to underestimate the difficulties that will be encountered when renegotiating tax treaties with other countries and its Proposals would hamper Canadian investment in developing countries and the development of Canadian-based multi-national corporations. We recommend that the present exemption for dividends received by Canadian companies from foreign affiliates be continued, and that other measures be used to stop "tax haven" abuse. We also recommend that capital gains realized by non-residents on shares of Canadian companies should remain exempt from Canadian tax.

Standing Senate Committee

We believe that adequate time should be allowed between the introduction of any bill to reform the tax system and its final enactment so that there is time for interested parties to make a detailed review of the resulting legislation.

* * *

If there are any areas in our submission upon which further details would be helpful, or if our comments on any other topics can be useful in your deliberations, we would be pleased to be of assistance.

**The Canadian Institute of Chartered Accountants
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COMMENTS ON PROPOSALS FOR TAX REFORM

**MADE TO
STANDING SENATE COMMITTEE
ON
BANKING, TRADE AND COMMERCE**

This submission is made on behalf of The Canadian Institute of Chartered Accountants, the national association representing nearly 18,000 Canadian chartered accountants.

The CICA's interest in improvement and reform of the Canadian tax structure is sufficiently well known so as to require little amplification. It is exemplified by its having maintained a Standing Committee on Taxation for over 20 years. One of the Committee's main functions is a regular examination of taxation legislation and its administration together with an annual review of tax changes. It has, either on its own or in conjunction with the Taxation Section of the Canadian Bar Association, made regular representations to successive Ministers of Finance and National Revenue in that connection. These submissions have also dealt with policy, loopholes, anomalies and other problems in our tax laws and made recommendations for the improvement of our tax system.

By way of background it should be stated that in 1963 the CICA submitted a brief to the Royal Commission on Taxation and members appeared before the Commission in Ottawa on several occasions. A further submission to the Minister of Finance in October 1967 presented the views of the CICA on the recommendations of the Royal Commission.

Within the time available to it, our Committee sought the views of many chartered accountants and other informed people in various parts of the country so that we would have as broad a base as possible on which to develop our thoughts. In particular, we received the assistance of the Taxation Committees of the various provincial Institutes.

It should be recognized that, in a profession with a large number of members, there are many widely differing opinions about any recommendations concerning such a subjective matter as taxation. We, therefore, do not necessarily speak for all chartered accountants. However, there is substantial agreement amongst the members of our Committee and members of Taxation Committees of the provincial Institutes as to the general thrust of our recommendations. We have footnoted those few recommendations where some of the provincial Institute Taxation Committees have taken a different stance.

This submission is by no means the only statement presenting the opinions of chartered accountants. The views of many members of our profession have been published or are set out in briefs already submitted or to be submitted by individual chartered accountants acting out of personal concern for the public interest.

In considering the probable effects of implementation of the recommendations contained in "Proposals for Tax Reform" and the administrative procedures that might be followed, we have used the practical knowledge we have gained as advisors to individuals, businessmen and corporate managers in all aspects of business and taxation. We do not have the resources comparable to those of the Government to examine and evaluate the economic and revenue effects of tax changes, but we believe our professional experience has particularly equipped us to appreciate the merits of many of the Proposals and to foresee the difficulties and problems inherent in others.

It is in this area of practical application of taxation legislation that our profession is able to make the greatest contribution, in the interests of both the taxpayer and the tax administrator. Consequently, we were somewhat disappointed to find that the Proposals for Tax Reform were limited to statements of principle and that detailed information as to the practical implementation of many of these principles is not yet forthcoming. Our experience in the field of taxation over the years has convinced us that tax legislation when enacted often has results that differ significantly from its apparent intent. We cannot express too strongly our view that adequate time should be made available between the introduction of any bill to reform the tax system and the final enactment of the resulting legislation so that a detailed review may be made by interested parties.

Before setting out our comments on specific Proposals we wish to outline the general approach that we consider desirable to a reform of the Canadian tax system. This general outline may place in better perspective our later comments on the detailed Proposals.

Early in the first chapter, the White Paper touches on the inevitable conflict between the objectives of equity and the need for growth and investment in the economy. We recognize the need for a widened tax base and a reduction in the burden of taxation on the lower income groups. However, we would be very concerned if, in the trade-off between immediate improvement in equity and longer-term growth, the choice was made for a system involving a low potential for growth, because such a choice would adversely affect all Canadians, no matter what their income level.

One of the effects of the Proposals, if enacted, would be a reduction of savings in the private sector. This reduction has been variously estimated between 3% and 10%. It has been suggested to your Committee that this need not result in an overall reduction in savings in the economy because the reduction in private sector savings can be compensated for by an increase in savings in the public sector. We are neither convinced that an equivalent increase in savings in the public sector would take place nor that, if it did, it would result in an equivalent increase in productivity.

One of the areas where we believe savings in the private sector will be adversely affected arises from the interaction of the proposed capital gains tax and the recently enacted amendments to the estate and gift taxes. What may be an acceptable level of estate tax in a structure

which does not include a tax on capital gains may be quite excessive in the context of a structure with a substantial tax on capital gains. An unacceptable reduction in savings will result if the Proposals are enacted without substantial reduction in the level of estate taxes that were imposed in October 1968.

Although we are not in a position to comment on the conflicting estimates of the increased tax revenues that would result from implementation of the Proposals, we are greatly concerned that even the more conservative of the estimates indicate a 5% increase (based on 1969 prices and incomes) by the fifth year in the aggregate tax burden imposed on the income and capital gains of Canadian individuals and corporations. When consideration is given to the anticipated increase in gross national product, to the effects of inflation and to full implementation of the proposed system (including the ultimate reduction in resource industry incentives), we are convinced that there would be a far greater increase in tax revenues than is immediately apparent. We believe that further studies should be made of the long-term revenue implications and, in any event, the need for an increase in revenues of this magnitude has not been demonstrated.

The overall increase in tax burden combined with the redistributive effects of the Proposals strikes particularly at the middle income group that is a major contributor to private sector savings. Additionally, a large proportion of the increase is to come from the corporate sector where, typically, there is a high degree of re-investment of cash flows.

Although the existing Canadian tax system contains technical and administrative weaknesses that require attention, we are by no means convinced that it deserved the level of criticism directed at it at the time of the appointment of the Royal Commission on Taxation. Subsequent events have shown that, given a firm stand by the tax administrators, some of the weaknesses of our present system were more apparent than real. Acknowledging as we have the need for a widened tax base and relief from taxation at the lower end of the income scale, we would have preferred to see this achieved by a more gradual transition from the present system. Our conviction is that it would be preferable to proceed with caution in an area of such uncertain consequences as tax reform.

In designing any tax structure, there will inevitably be certain areas where taxpayers may take undue advantage of technical weaknesses. Although we believe that loopholes should be eliminated, it is essential that legislation designed to prevent a few taxpayers escaping their proper burden of taxation does not unjustly penalize the rest. There are certain sections of the White Paper that leave the distinct impression of an undue concern with the prevention of tax avoidance. We believe that this over-emphasis on prevention of potential tax abuses may have an inhibiting effect upon legitimate business activity.

We have noted with regret the absence of any proposals relating to changes in the administration of the Department of National Revenue. The implementation of any large part of the White Paper Proposals will result in a need for continuous review and adjustment and, unquestionably, a need for more regulations and information issued at shorter intervals.

The Proposals make it essential that speedy advance rulings be available in connection with business re-organizations immediately upon implementation of the legislation. This will require the Department of National Revenue to increase the qualifications of its officers and to expand substantially their numbers. In view of the foregoing, we believe that the originally suggested implementation date of 1 January 1971 is unrealistic. Any attempt to rush legislation through in an attempt to meet that date will inevitably cause confusion and a rash of technical amendments, resulting in an intolerable strain on tax administrators, taxpayers and tax advisors alike.*

It is imperative that implementation of any substantial structural reform such as is contemplated has the co-operation of provincial governments. Lack of provincial co-operation could result in greater inequities than those the system is intended to rectify.

Certain of the Proposals for taxation of flows of income between Canada and other countries represent departures from the international norm. Lack of co-ordination with the tax laws of countries with which we have substantial trading relations can result in major inequities to taxpayers of both countries. Consequently, we believe that any unilateral departures from accepted methods of taxing international income flows can only be justified if they are demonstrably and significantly advantageous to Canada. This same test of substantial advantage to Canada should also be applied in assessing the desirability of bringing to Canadian tax international income flows which have had the advantage of tax incentives or tax sparing in other countries. An undue concern with international tax avoidance should not be allowed to inhibit desirable Canadian investment abroad.

Our comments on the specific Proposals in the White Paper follow under appropriate captions. These captions have been set out under main headings that conform basically to the chapters in the White Paper.

* The experience in the United Kingdom when capital gains tax was introduced there, fully supports this contention.

INDIVIDUAL AND FAMILYPersonal Exemptions:

We commend the Proposal to lighten the income tax burden on lower income families. Such changes are extremely expensive in revenue terms - the increase in basic personal exemptions will reduce tax revenues by one billion dollars a year - and, consequently, taxes imposed on higher income groups will have to be increased to make up the deficiency. We appreciate that the allocation of the tax burden amongst various income classes is a complex and difficult problem, but we are concerned that the disadvantages to Canada of placing too high a burden of tax on middle and upper income taxpayers may be underestimated.

We note that the White Paper proposes to retain the present system of personal exemptions rather than to move to a method involving tax credits as suggested by the Royal Commission on Taxation. Our view is that a system involving the application of credits against taxes, instead of exemptions against income, may well be a more flexible and appropriate method of providing an initial exemption from personal taxes as well as an allowance for dependents. One advantage of such a credit system is that it is easier to adjust the initial relief to take account of the effects of inflation than it is to increase exemptions. (The latter change may require an adjustment of the rate schedule if appropriate relief is to be extended to low income taxpayers without large revenue costs.)

We suggest that, after the implementation of the presently proposed changes;

- (a) the Government again review the desirability of introducing tax credits in lieu of personal exemptions; and
- (b) consideration be given to exempting completely single taxpayers earning less than (say) \$2,000 and married taxpayers earning less than (say) \$4,000 with the tax liabilities of all taxpayers earning significantly more than these amounts remaining unchanged. (A "notch" provision could be used to ensure that taxpayers earning only slightly in excess of the increased exemption limits would be subject to only a moderate marginal tax rate on the excess of income over the increased limits.)

Family Unit:

We note that the Government has rejected, at least for the present, the use of some sort of "family unit" as the basis of the imposition of personal income taxes. The White Paper indicates * that, after the present Proposals have been implemented, the Government might reconsider this rejection. We believe that the husband and wife unit would provide a more equitable basis for taxing married couples because their combined tax burden would vary only in relation to their total income and

* Proposals for Tax Reform, Paragraph 2.5

not with the distribution of that income between the spouses. Such a unit would require a separate rate schedule providing a tax burden which represented a reasonable compromise between the advantages of full income splitting and the disadvantages of income aggregation.

We suggest that, after the present Proposals have been dealt with, the Government give serious consideration to adopting a husband and wife unit as the basis for imposing personal income taxes.

Child Care Deductions:

We support the recommendations of the Government in this area, although the Proposals would have made somewhat more sense in a system providing for the joint taxation of husbands and wives. We suggest, however, that child care is not the only personal responsibility that must be met in order to enter the labour force.

We recommend that the proposed child care deductions should be extended to permit a similar allowance for the necessary cost of caring for an incapacitated wife or husband, when the other spouse is employed.

Additional Elements of Income:

We agree with the proposed inclusion in income of most types of welfare payments, unemployment insurance benefits, and fellowships and scholarships. Indeed, we would go further because we can see no reason in theory why virtually all periodic welfare payments, including benefits paid subject to a needs test and some types of workmen's compensation and private sickness insurance benefits, should not be included in income.

We are, however, concerned about the possible effects that the taxation of such amounts might have on the position of some of the recipients of those benefits, especially those with lower incomes. The taxation of a number of such welfare payments should only be commenced when, after consultation with the provinces, the level of the payments has been appropriately adjusted to take into account their taxability.

We are also concerned about the adverse effects of including certain types of scholarship and similar payments in income. The taxation of such amounts may be appropriate at the post-secondary school level, (and more especially with respect to post-graduate fellowships) where the student concerned can deduct the cost of his tuition for tax purposes and is also the indirect beneficiary of Government assistance. However, it seems inappropriate in cases where the student is attending an educational institution of less than post-secondary school standing. The taxation of those scholarships and bursaries could result in the child's parent losing the dependent child allowance despite the fact that the child remains dependent and, in some cases, it could render the child taxable. Furthermore, the taxation of nominal prizes, awards and other school distinctions seems clearly inappropriate. We do not think adequate consideration has been given to the implications of this change on payments made by a number of employers towards the education

of the children of employees residing at remote locations.

There appears to be no justification for the omission of strike pay and similar benefits from the income base, particularly when the funds for such payments usually originate either from tax deductible union dues or from tax exempt investment income of unions. The Report of the Royal Commission on Taxation recommended inclusions of strike benefits in income for tax purposes, and we are surprised that the Government did not adopt this recommendation.

We recommend that:

- (a) all periodic welfare and similar benefits be included in income after the level of payments has been appropriately adjusted;
- (b) scholarships to schools where tuition is not a deductible expense continue to be excluded from income;
- (c) relatively minor scholarship awards be excluded from income especially when received in a non-monetary form;
- (d) other fellowships and scholarships be included in income after the level of such payments originating in the Government sector has been appropriately adjusted;
- (e) strike pay be included in income for tax purposes.

Retirement Plans:

We are in favour of the Proposal that limitations on contributions to pension and other similar plans should ultimately be based on retirement benefits to be provided rather than on annual limitations on contributions. This change would provide greater equity to older taxpayers and to taxpayers whose incomes are irregular.

We recommend that:

- (a) as soon as reasonable limits based on retirement benefits can be established, the present annual limitation of \$2,500. for contributions to registered retirement savings plans should be increased, and, ultimately, annual contribution limits be eliminated. Contribution limitations to other retirement plans should be similarly adjusted;
- (b) as an interim measure, the limitations on contributions to a registered retirement savings plan should be immediately amended to provide a more generous annual maximum deduction, subject to some overall cumulative lifetime limit. For example, taxpayers who did not take maximum advantage of permissible deductions in prior years should be allowed to make good the deficiency by means of additional deductible payments.

Taxation of Lump Sum Payments:

One of the effects of substituting a general averaging provision for the existing sections that provide relief in respect of specific types of lump sum payments, would be a substantial increase in the tax imposed on them. Although an increase on such lump sum receipts may be justified, we believe that appropriate transitional provisions are necessary. We are particularly concerned about persons who may have purchased long-term investments or made other arrangements in the expectation that existing special tax provisions would continue. They should be given time to

withdraw to the extent they can and wish to do so.

The taxation of lump sum withdrawals from registered retirement and other pension plans at the taxpayer's marginal tax rates can lead to the imposition of a relatively heavy tax burden which the limited general income averaging proposal does little to alleviate. This is particularly true considering that such payments include capital gains and dividend income which would have been entitled to favourable tax treatment if received by the taxpayer. Although we are not prepared to recommend more favourable treatment for lump sum payments received during a person's lifetime (partially because of the potential for abuse), we do favour some special relief for such payments received on a taxpayer's death at which time they will be subject to estate taxes as well as income taxes. This special relief is desirable in addition to the suggested "roll-over" to a registered retirement savings plan for the benefit of the deceased's spouse.

We recommend that:

- (a) the existing favourable averaging provisions, such as Sections 35 and 36, should be left fully in effect for a period of at least three years following the new tax system;
- (b) lower income tax rates (perhaps up to a maximum of 25%) should be imposed on lump sum payments received on death, where the "roll-over" to a pension plan for the benefit of a surviving widow is not available or is not elected.*

Payment of Pensions Abroad:

We have serious concern about the Proposal to impose tax on pensions paid to non-residents of Canada. Payments of pensions to non-residents of Canada should under no circumstances bear Canadian tax at a rate higher than would prevail if they were living in Canada. In view of the fact that the non-residents have given up certain benefits of Canadian residence, a lower level of taxation may even be appropriate. The proposed rate of withholding tax of 25% applied to the entire amount of a pension payment without exemptions represents a very heavy tax burden - far higher than would be borne by almost all pensions received by Canadian residents. To subject pension payments to non-residents to a tax of this magnitude will cause serious hardship to a number of Canadians who plan to retire abroad (perhaps to their country of origin for sentimental reasons, to a milder climate for health reasons or because the cost of living abroad may be lower than in Canada). If the Proposal is to be applied to existing benefits, the retirement arrangements of many persons would be seriously disrupted.

We recommend that the implications of the proposed tax be studied again before it is implemented. In particular, every effort should be made to avoid the imposition of an unduly heavy tax on relatively small payments and on the existing

* This would be equivalent to taxing the payment at approximately the same rates suggested in the White Paper as being appropriate for shares of Canadian widely-held companies and the maximum rates we have suggested should apply to all long term capital gains.

pensions of persons now living outside Canada. Any tax imposed should be related to the amount of pension and the economic circumstances of the recipient and the Government should be prepared to modify such tax provisions in tax treaties. In any event, no Canadian tax should apply to pensions paid from Canada in respect of services rendered outside of Canada.

Immediate Reduction of Top Personal Rates:

The White Paper proposes* that the present maximum rate of personal income tax should be reduced to approximately 50% over a four year transitional period beginning in the second year of the new system.

While in general agreement with the conclusion that it would be desirable to have a top rate of personal income tax not significantly different from the corporation tax rate and therefore close to 50%, we find the argument that this top rate can only be introduced over a four year transitional period unconvincing, particularly the argument that the phased reduction in rates should correspond with the increase in the effectiveness of taxation of capital gains. In the first instance, much of the incomes in excess of \$24,000 a year will not consist of capital gains, and there is no logical reason why the reduction in tax on such incomes should depend on the effectiveness of the taxation of capital gains. Secondly, to the extent that the high rates are applied to capital gains, we fail to see why the lower rates of personal tax need be phased in only as the taxation of capital gains "becomes fully effective". For those taxpayers who realize large capital gains in the first few years of the system it is fully effective and they should have the immediate benefit of the lower rates.

We foresee major difficulties and inequities in the imposition and administration of our taxation system if the reduction of the top personal rate is phased in over a five year period. For example:

- (a) high bracket taxpayers will make every effort to postpone the receipt of taxable income during the transitional period and bonuses will be deferred, realization of capital gains will be avoided, and other forms of income will be dammed up to await the lower tax rate promised for future years.** These actions will have undesirable business and economic effects and may reduce Government tax revenues in the short run;
- (b) during the transitional period, ordinary capital gains could be taxed at rates in excess of 80% and gains on the sale of shares of public Canadian companies could be taxed at rates in excess of 40%. While we appreciate that the taxable portion of the gain would be limited to increases in market value accruing after the start of the new system, inevitable fluctuations in market values could result in some Canadians realizing large gains regarded as having accrued over a very

* For the reasons set out in paragraphs 2.39 to 2.42

** This is further complicated by the 2½-year limitation on availability of creditable tax--see paragraph D.22

short period, even though they might merely represent a recovery of a previously accrued loss. We can find no justification for taxing gains at such high rates.

We, therefore, strongly recommend that the reduction in top rate of personal income taxes to approximately 50% be implemented immediately at the start of the new system.

Tax Rates of Middle Income Taxpayers:

The Report of the Royal Commission on Taxation recommended that the income tax burden of middle income taxpayers such as skilled workers, executives and members of professions should be reduced. The White Paper on the other hand, has proposed an increase in the taxes on the same group of Canadians.

We have compared the tax rates suggested for middle income Canadians under the White Paper Proposals with those that will prevail in the United States after full implementation of that country's recent tax legislation. We recognize that any comparison of tax burdens in Canada and the United States involves a number of technical difficulties and that, furthermore, the level of a country's taxes is directly related to the level of government benefits provided. We also appreciate that Canada is providing its level of benefits from taxes imposed on a substantially lower per capita income base than does the United States and hence higher taxes are required in Canada to provide a similar level of government benefits. However, we are concerned with the very sharp disparity which this comparison has shown, particularly as it affects the middle income group which, we believe, is particularly sensitive to large differences in taxation. We do not suggest that large numbers of Canadians will be induced to move to the United States because there are many factors, other than tax rates, that influence citizens as to where they will choose to work and live. However, we are convinced that these large differences will induce some Canadians, particularly those with special skills and training, to leave Canada and, perhaps more significantly, they will serve as a disincentive for prospective skilled immigrants to Canada.

In addition to the higher aggregate tax burden on individual taxpayers we are concerned with the present high marginal rates of personal tax which will be continued and in some cases accentuated by the White Paper Proposals; it is marginal rates, even more than average rates, that serve as a disincentive to effort and initiative. (The marginal tax rates proposed in the White Paper are substantially higher than the corresponding effective marginal rates of tax in the United States at most income levels.)

We fully appreciate that any reduction in tax rates applicable to middle income taxpayers will be costly in revenue terms. However, we note that the Government's own estimates of the revenue to be raised in the fifth year of the new system show an increase of \$630 million based on 1969 incomes and price levels. These estimates of revenue increase are undoubtedly conservative when projected to 1975, and we believe that the new tax system when fully implemented will increase Government revenues even more. We consider that a substantial portion of any increased revenue should be used to effect rate reductions in the middle income range.

We strongly recommend that, as the new tax system matures, and as additional revenues become available to the Government, the tax burden on middle income Canadians should be reduced and the rate schedule made less steep so that the maximum rate of personal income tax is not reached until (say) \$50,000. or \$100,000. of income.

In addition, when the legislation to implement Tax Reform is presented, we would prefer to see it contain rate schedules for immediate enactment into law that, if applied to a fully matured system, would produce approximately the same aggregate personal income tax revenues as does the present system. The resulting shortfall in Government tax revenues during early transitional years would be made good through the imposition of temporary surtaxes with fixed expiry dates.

Income Averaging:

We support the introduction of some form of general averaging into the Canadian tax system, but we believe the particular averaging Proposals suggested are inadequate to provide effective relief for fluctuating incomes.* A system of effective averaging is essential to the fairness of the new tax system, not only for fluctuating incomes but also because capital gains (frequently received in an uneven manner over time) are to be included in income.

Income averaging should, in theory, be allowed for declines in incomes as well as increases but we recognize the substantial revenue costs of permitting averaging in years of declining income to those retiring. We are impressed by the equitable arguments in favour of allowing some form of averaging where the decline in income is not related to voluntary withdrawal from the labour force.

We believe that the best possible system would be one involving moving block averaging, whereby a taxpayer each year would be allowed, in effect, to average his income of that year with his income of previous years. Such a system would allow very generous averaging benefits at a considerable cost in foregone Government revenues but can be fully justified on equitable grounds.

We suggest that the Government review the possibilities of introducing a system of moving block averaging over a five-year period for all taxpayers.

If the immediate adoption of a system of moving block averaging is not acceptable, we recommend that:

- (a) the "threshold limit" of income that must be reached in any one year to qualify for income averaging under the White Paper Proposal should be reduced from 133-1/3% to 125% of the average income of the four preceding years;
- (b) income in excess of the "threshold limit" be taxed at the

* We recognize that some of the inadequacies of the Proposal relate to the extreme steepness of the tax rate schedule, which reaches a maximum at \$24,000 a year of taxable income.

actual rates that would apply to such excess if it were added evenly to the average income of the past four years instead of being added to the "threshold limit";

- (c) the possibility of allowing some modified version of income averaging for substantial income declines (say 20% below the average of the previous four years) be studied. This relief would be made available to a closely-defined group of taxpayers who were still in the labour force and who otherwise met stated criteria;
- (d) the Government re-examine the merits of "deposit averaging" whereby taxpayers could make deductible deposits to a fund administered by the Department and would be taxable on such amounts when withdrawn. This would permit voluntary averaging and would be a useful adjunct to any system of general averaging.

Allowance for Employment Expenses:

The Proposals include a recommendation that all employees be allowed a general deduction for expenses incurred to earn income. In lieu of permitting employees to claim deductions for actual expenses, the White Paper suggests that employees continue to be restricted as to the type of expenses they can claim but that they be permitted an additional deduction of 3% of employment income to a maximum of \$150.

We are in agreement that no useful purpose would be served by permitting or requiring taxpayers to claim a variety of employment-related expenses because difficulties of administration would more than outweigh any small increase in equity that would result. However, we object to the White Paper's Proposal in this area on two important grounds:

- (a) first, the Proposals would not provide appropriate relief for those taxpayers who do have properly substantiated and clearly justified employment expenses in excess of the maximum, and
- (b) secondly, the employment expense allowance proposed is essentially a tax reduction, available only to a limited group of taxpayers, that results in a substantial loss in tax revenues.

We also believe that existing sections of the Income Tax Act dealing with deductions from employment income need thorough revision. The range of deductible expenses should be somewhat broadened to include, for example, the cost of tools that employees in certain limited and specified occupations are required to provide. Present inequities, of which the following are examples, should be eliminated:

- (a) an employee in the transportation industry can deduct certain expenses if his employer's principal business is in that industry but cannot deduct them if it is not;
- (b) a relieving railway telegrapher can deduct certain expenses while a relieving retail store manager may not.

There is a pressing need for these provisions to be simplified and made more logical.

If the existing sections dealing with deductions from employment

income are modified and improved, the need for an arbitrary employment "expense" allowance of the size proposed is not necessary and the existing "standard deduction" of \$100. for medical expenses and charitable donations might well be expanded to include a more reasonable employment expense allowance. We believe that this suggestion would be less costly in revenue terms and be more equitable than the proposed allowance.

We recommend that:

- (a) the Government completely revise and codify the existing sections of the Income Tax Act relating to the deduction of specified expenses by employees;
- (b) all of the sundry deductions from income such as medical expenses, charitable donations, union and professional dues, and employment or similar expenses be grouped together and that taxpayers be allowed to claim either a standard deduction or the actual amount of such deductions. Specifically, we suggest that all taxpayers be allowed a deduction of the larger of the following amounts:
 - (i) \$100 plus 1% of earned income but limited to an overall maximum of \$150.
 - (ii) the sum of actual expenditures (supported by receipts) for
 - charitable donations
 - health expenses in excess of the "floor" amount
 - union and professional dues
 - any itemized employment expenses and any expenses incurred personally and related to the earnings of business or professional income.

CAPITAL GAINS

The White Paper proposes that capital gains be subjected to a progressive tax as part of the general income system. That is, unless some special provision is made for a particular type of capital asset, any gain on its realization would be included in income and taxed at the taxpayer's marginal rate.

Although we agree that some form of taxation of capital gains will tend to improve the overall equity of the tax system, we do not consider that it is appropriate to tax all types of capital gains as ordinary income. We do not believe that the Proposal gives adequate consideration to such problems as these:

- (a) the effects of inflation which will result in illusory gains being taxed;
- (b) the meagre averaging provisions proposed (reference has already been made to this in paragraphs B.30 to B.34); such averaging is particularly important in the taxation of gains that are received irregularly;
- (c) the fact that capital gains would tend to be taxed at rates above the taxpayer's normal marginal rate while losses would tend to be allowed at rates below his normal marginal rate;^{*}
- (d) the detrimental effect of the full taxation of capital gains on the motivation of individual Canadians to accumulate capital;
- (e) the diminution in growth resulting from the taxation of capital gains and consequently reduce savings in the private sector;
- (f) the desirability of encouraging certain types of capital investment, for example, private home ownership, and equity investment.

Consequently, we believe that a better approach is to examine the various types of capital gain that may arise and to determine an appropriate level of taxation for each. Before doing so, there are two major points we wish to make in connection with the transitional rate schedules and the relationship of capital gains tax to estate tax. These points are discussed paragraphs C.3 to C.8 following.

Transitional Rate Schedules:

A system of taxation including all or a portion of capital gains in the income base taxable at a maximum rate of approximately 50% may be reasonable, but it is inequitable for the individual who, either involuntarily or inadvertently, realizes a capital gain in the transitional period and finds it subject to taxation at rates substantially in excess of 50%. We have recommended in paragraph B.23 that the higher marginal rates

* A taxpayer with a constant taxable income of \$16,000 realizing a \$5,000 capital gain faces additional tax of \$2,304. The same taxpayer realizing a capital loss of a similar amount in a subsequent year would obtain a tax reduction of only \$2,035.

be eliminated immediately upon implementation, rather than over a five-year period.

If our recommendation for immediate elimination of the higher marginal rates is not accepted, we strongly recommend that for capital gains realized during the transitional period, the tax on the portion of such gains included in income should not exceed the ultimately proposed maximum rate of approximately 50%.

Relationship to Estate Taxes:

As indicated in the introduction to this submission, the weight of estate taxes appropriate in the absence of a capital gains tax is likely to be excessive where there is a substantial capital gains tax. We believe that if the proposed capital gains tax, or our suggested modifications to it, were imposed in conjunction with the existing estate and other death tax legislation, the combined burden of these taxes would be excessive. Some indication that this is so can be inferred from the recommendation in the Proposals that, on death, assets be "rolled over" to the heir at their "cost basis" to the deceased.* This suggestion recognizes that the combined impact of the proposed capital gains tax and the existing estate tax at one point in time is too heavy a burden. In addition we believe that the deferral of the application of capital gains tax on inherited assets until realization by the heirs carries with it the seeds of future problems.

Accordingly, we would prefer to see the accrued capital gains on assets held by a taxpayer at death (except on assets left to a surviving spouse) taxed at that time provided this is accompanied by a substantial increase in exemptions and reductions in rates of estate tax. We further suggest that capital gains levied be deductible in computing the value of the estate and the heir would be considered to have purchased the assets at the value used in determining the capital gain. We believe this approach has merit in that a taxpayer's liabilities for all taxes will be settled at his death (or that of his spouse if later) and there will be no carry-over of tax liabilities to succeeding generations. Our proposal also conforms to our underlying attitude towards estate tax - namely, that it should be used primarily to prevent undue accumulations of wealth in a limited number of hands, and that its contribution towards Government revenues should be incidental.

We realize that our proposal for a deemed realization on death combined with some remaining burden of death taxes could create difficulties, but we hope that our other recommendations regarding taxation of gains on principal residences and personal assets together with our recommendation for reduction in estate taxes will prove to be an adequate overall solution.

We recommend that (except on a bequest to a surviving spouse) accrued capital gains be deemed to be realized on death** and

* "Roll-over", in this context, is the procedure whereby no tax is levied on a gain accrued at the death of a taxpayer but the heir is assumed to have acquired the asset at the deceased's cost. In this way tax on the gain is postponed until it is finally realized by the heir.

** One of the provincial Institute Taxation Committees was not in favour of this recommendation.

that the exemptions and rates of estate tax should be modified as follows:

- (a) the minimum exemption should be in the order of \$200,000;
- (b) the rates should range from 15% to a maximum of (say) 35% where the estate value exceeds (say) \$2,000,000. Concomitant amendments to the gift tax exemptions and rates would also be necessary.

We appreciate that the recommendation made in paragraph C.8 when taken in conjunction with our rejection of the five-year revaluation proposal for shares in widely-held Canadian companies (see paragraphs D.40 to D.43) may require some restriction on the deductibility of realized losses and may have implications as to the availability of tax-free share exchanges. Nonetheless, we believe our proposal has sufficient merit to compensate for those drawbacks.

The recommendations that follow must be read in the context of the preceding paragraphs. We emphasize that we cannot endorse these recommendations in the absence of substantial modification to the estate tax legislation along the lines we have suggested.

Categories of Capital Gains:

We have considered the appropriate tax treatment for capital gains in the following categories:

- (a) shares of Canadian corporations
- (b) bonds, mortgages and agreements for sale
- (c) principal residences
- (d) other personal assets
- (e) other capital assets, including real estate, shares of foreign corporations and goodwill.

Shares of Canadian Corporations:

Because the treatment of shares of Canadian companies is inextricably linked with the treatment of dividends from Canadian corporations, this type of gain is dealt with under the succeeding main caption "Corporations and Shareholders" but, essentially, we recommend the inclusion in income of 50% of gains on realization of shares of all Canadian corporations and deduction of 50% of losses.

General Rule:

In our discussions as to what might be a suitable general rule to apply to the taxation of capital gains, we considered many alternatives that would make an appropriate allowance for the differences from ordinary income. We are particularly concerned that the taxing of gains on the sale of assets which have been held over a number of years can in fact be a tax on one's own capital because of the effects of inflation. On the other hand these arguments are not as compelling when applied to the taxation of shorter term gains. We eventually concluded that any general rule could only be an arbitrary method of recognizing a number of the factors and that specific relief could not be given except by introducing an unacceptable degree of complexity. Accordingly, we have concluded that some modification of the general inclusion of gains in ordinary income would be most appropriate.

We recommend that for capital assets (other than those for which special treatment is recommended under ensuing captions) any gain should be included in income in full unless the asset has been held for a period in excess of (say) three years. If held for a period longer than this, a reducing percentage of the gain should be included in income. The reduction should be so scaled that the percentage inclusion in income would drop to 50% if the asset had been held for (say) thirteen years.* Similar rules would apply to losses. Where there has been a forced realization (for example, expropriation or destruction of the asset), or on death, only half the gain would be included in income, regardless of the actual holding period.

As stated in paragraph C.9, our rejection of the five-year revaluation proposal for shares in widely-held Canadian companies and the reducing percentage of gain or loss recognized as the length of time the asset is owned increases, requires some restriction on the deductibility of losses. If taxpayers were able to defer realization of gains until only 50% was taxable and, at the same time, were allowed to deduct losses early when higher proportions of the loss would be recognized, there would be some distortion in normal investment patterns and a reduction in revenue. It is necessary to impose some restriction upon the deductibility of losses but we believe these restrictions need only apply to shares of corporations (both Canadian and foreign), as these are by and large the only assets for which there is a ready market.

We recommend that for shares:**

- (a) realized capital losses be deductible against capital gains realized in the same year;
- (b) the excess of capital losses over capital gains realized in any year be deductible against other income to a maximum of \$2,000;
- (c) realized losses not deductible under (a) and (b) be deductible against any net capital gains realized in the immediately preceding years;
- (d) realized losses not deductible under any of the preceding sub-paragraphs be deductible against any future net capital gains without time limitation; and
- (e) where a realized loss has been sustained in excess of the limits in (a) and (b) above, the taxpayer be permitted to revalue to market all shares owned by him, and deduct any resultant net loss from any other type of income. Any loss in excess of other income would be eligible for carry-back

* This rule would not be as arbitrary and unfair as the "short term-long term" distinction found in other countries in that it envisages a reduction of 5% for each year after three that the asset has been held.

** Special (and less restrictive) rules would be necessary for losses sustained on shares of corporations electing the partnership option (see Section D of this submission). Some alleviation of these restrictions might also be necessary in the case of losses on shares of foreign subsidiaries.

and carry-forward against any other income.*

Bonds, Mortgages, Agreements for Sale:

We agree that most taxpayers who acquire bonds, mortgages and agreements for sale at a discount are essentially choosing to realize their interest return in a different form.

We commend the Government's Proposal (and the subsequent extension of it) to compute gains on these assets with reference to their original cost rather than to their value on valuation day.

In the light of the Proposal to tax gains arising from issuance of bonds at a discount and their redemption at a premium, we assume that the discount or premium would be deductible to the issuer (unless incurred in connection with personal non-income producing assets or activities).

Consequently, we agree that gains from the sale of such assets be included in income to their full extent and, similarly, that losses be fully deductible.

Principal Residences:

Paragraph 3.19 of the White Paper opens with the statement "generally, capital gains on the sale of homes would not be taxed". It then goes on to suggest a reduction in the amount of capital gain equal to \$1,000 per year of occupancy. In his appearance before the Standing Committee on Finance, Trade & Economic Affairs on 15 January 1970, the Minister of Finance stated that he expected to collect no revenue from taxation of principal residence gains except for windfall gains that might arise from re-zoning, etc. We agree with the intent expressed but we are of the opinion that \$1,000 per year is an inadequate amount to achieve the stated objective in all parts of the country.

The White Paper proposes that where a taxpayer moves from one area to another within Canada in connection with a job change, any gain realized on the sale of his home would not be taxed at that time provided he spent the proceeds within one year on the purchase of another home in the new locale. Instead the gain on the old house would be deemed to reduce the cost of the new house. We consider this restricted "roll-over" provision to be inadequate and undesirable. We believe it is important that no tax impediment be placed in the way of a taxpayer changing his principal residence, whether the change be dictated by reason of increases or decreases in the number of dependents or merely by a desire to change to a residence more suitable to the taxpayer's economic circumstances. Because of fluctuations in values over time, "roll-over" provisions are also necessary to make the annual allowance provision effective. The very limited "roll-over" provision suggested in the White Paper could have the unfortunate effect of forcing taxpayers to remain in residences which were quite unsuitable to their changing responsibilities and could lead only to an inefficient allocation of Canada's housing stock.

We strongly recommend that:

- (a) a more generous allowance in the order of \$2,000 per year of occupancy be made and that the home improvement allowance be increased to \$200 per year of occupancy. Where,

* Losses on all other non-personal assets would be deductible against other income.

despite application of cumulative annual allowances, a gain is realized, its taxation should be subject to the general rule recommended in paragraph C.14. The same provisions should apply on the sale of a farm with a farmhouse that has been the principal residence.

In order to eliminate record-keeping for many homeowners we also recommend that provision be made for an assumed minimum cost of (say) \$25,000.

- (b) a "roll-over" be permitted on the re-investment of the proceeds of sale of one residence in another within a limited period no matter what the reason for the change in residence.
- (c) subject to our proposed substantial modification of estate tax, that the gift or bequest of the principal residence to other than the surviving spouse be deemed to be a realization. Where the residence is bequeathed to a surviving spouse, that person should take over the residence at the "cost basis" of the deceased, modified by the accumulated annual tax-free increment.

Other Personal Assets:

As in the case of the principal residence proposals, we believe that the lower limit of \$500 suggested in paragraph 3.23 of the White Paper does not go far enough in its intent to reduce nuisance record-keeping on the part of the taxpayer or to eliminate burdensome and profitless activities imposed on the administration - profitless in the sense that the revenues collected will justify neither the cost of collection nor the deterioration in taxpayer/administration relationships that is likely to emerge from differences of opinion over essentially petty amounts. Many taxpayers have major personal assets such as summer cottages. These tend to be owned for a number of years and accordingly on their sale, could attract significant tax. We believe that an annual exemption of \$500 (or \$1,000 as we have recommended) would be unduly restrictive in such circumstances; we therefore suggest the possibility that a \$25,000 lifetime exemption be considered.

We recommend that:

- (a) where proceeds of sale of an asset are less than \$1,000 no gain be recognized;
- (b) where proceeds do exceed \$1,000 any gain be computed by reference to a deemed cost of \$1,000 or actual cost, if greater;
- (c) any gain computed under (b) be reduced by an annual non-cumulative exemption of \$1,000;* and

* To illustrate, if a taxpayer acquired a personal asset for \$750 and sold it thirteen years later for \$3,000 his taxable gain would be computed as follows:

Proceeds	\$3,000
Deemed Cost	<u>1,000</u>
	\$2,000
Annual Exemption	<u>1,000</u>
	\$1,000
Holding period reduction (50% see paragraph C.14)	<u>500</u>
Included in income	<u>\$ 500</u>

- (d) if feasible, we recommend the eventual substitution of a \$25,000 lifetime exemption for gains on sale of personal assets be substituted for the \$1,000 annual non-accumulative exemption referred to in (c) above.

In paragraph 3.26 of the White Paper, it is proposed that losses realized on certain types of personal assets be deductible only from gains on the same type of asset realized in either the year immediately preceding or that immediately following. We agree that losses on this type of asset should not be deductible against other types of gains or against other income but we believe that the proposed limit of carry-forward of loss to one year only is unnecessarily restrictive.

We recommend that the proposed limitation on offset of losses on personal assets against gains on similar assets be changed to permit carry-forward of such losses for at least five years.

Other Capital Assets:

Capital assets, apart from those to which specific reference has been made above, should fall under the general rule we propose for the taxation of capital gains. These assets would include real estate, shares in non-Canadian corporations and goodwill (to which reference is made in paragraphs E.2 to E.9).

Deemed Realization:

We agree that to preserve the integrity of the tax on capital gains, provision for some form of "deemed realizations" is necessary to prevent indefinite deferral of gains. We have already recommended that, subject to the conditions outlined, realization be deemed to take place on death. It follows that we agree with the Proposals that realization be deemed to occur where property is gifted. We are concerned, however, to note that there is no apparent provision for exemption from "deemed realizations" on gifts where the donee is the spouse or a charitable organization. We believe exceptions to the general rule are justified in each case. For gifts to a spouse, such an exception would conform to the concept of the husband-wife unit and would harmonize with the estate tax provisions. In the case of gifts to charities, the exception is necessary if gifts of assets on which capital gains have accrued are not to be inhibited.

In conformity with our recommendation in paragraph C.8 with respect to "deemed realization" on death, we recommend that no realization be recognized for capital gains purposes on a gift to a spouse and that the spouse be assumed to have acquired the gifted property at a price equal to the "cost basis" of the donor.

We also recommend that no realization be deemed on gift to a charitable organization but that the quantum of the charitable donation be restricted to the "cost basis" of the donor.

The Proposals concerning deemed realization on immigration to and emigration from Canada are discussed in the section F dealing with "International Income".

Roll-Overs:

We concur in the Proposals for roll-overs in cases of forced realization and we agree with the principles underlying the suggested treatment in corporate/shareholder transactions. This latter type of transaction is discussed in paragraphs D.49 to D.51 of this submission but we wish to reiterate here that adequate provisions must be made so that desirable corporate organizations or reorganizations are not inhibited by tax penalties or by delays and difficulties in obtaining advance rulings as to the tax consequences of proposed courses of action. The guiding principle should be that tax-free exchanges be permitted as liberally as is consistent with preservation of the integrity of the system. We appreciate the difficulties in setting out particularized rules in this area. It is the imperative need for skilled judgements and speedy rulings in this area amongst others that prompted our comments in paragraph A.17 of this submission.

Valuations:

It has been suggested that the valuation of particular assets on valuation day will not become an issue between the taxpayer and the taxation authorities until such time as a disposal takes place. The suggestion implies that the Department of National Revenue will not be prepared to discuss valuations with taxpayers until such time as an asset has been sold. Whilst this serves the useful purpose of eliminating the tremendous pressures that would develop if valuations of all assets without readily ascertainable market values had to be agreed within a reasonable period after valuation date, it does leave the negotiated value to be settled at a date which could be many years after the event - a situation which introduces a degree of uncertainty which we believe to be inappropriate. In measuring the desirability of the sale of a particular capital asset and re-investment of the proceeds in an alternative capital asset, the taxpayer is distinctly disadvantaged if he does not know with reasonable certainty what his after tax proceeds will be.

We fully appreciate the many transitional problems involved including the difficulty of determining realistic valuations and the potential revenue losses that would result from over-valuation on the introduction of capital gains tax. Nonetheless, we are convinced that there is a need for generous (perhaps overly generous) formulae to reduce the number of valuations required and to alleviate the inevitable pressures on the administration.* The use of the formulae should be optional to the taxpayer and although it may be necessary to provide that taxpayers opting to establish values other than on the formula basis be committed to fair market valuation even though that ultimately proves to be less than the formula valuation.

Consequently we recommend that alternative methods of valuation of the assets at the beginning of the system be provided. In particular we recommend that "safe haven" rules be developed. Those "safe haven" rules might spell out a range of acceptable

* The Royal Commission on Taxation made a similar recommendation that "liberal procedures should apply to determine the value of assets held as at the effective date".

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methods of valuation within which the taxpayer's valuation would be accepted without further challenge. As examples only, the following could be considered:

- (a) * for principal residences, value on valuation day might be computed by reference to original cost plus the annual allowances recommended in paragraph C.22;
- (b) for assets other than readily marketable securities held on valuation day, the gain relevant to the period after implementation date could be computed by pro-rating the gain from original cost to sale in relation to the period from implementation day to date of disposal. * This would be an optional method of computation. It might apply to all assets (other than readily marketable securities and principal residences) for a period of five years after implementation and be restricted thereafter to personal assets;
- (c) for substantial blocks of readily marketable securities where use of stock market quotations may produce a result that does not truly reflect the value of the block, the taxpayer should have the right to establish a true market value, preferably by negotiation within a limited period.

In conclusion, we must emphasize again our conviction that the existing levels of estate tax must be substantially modified along the lines set out in paragraph C.8, whether either the White Paper Proposals or those recommended by us in the preceding paragraphs are implemented. In the absence of such a modification, we cannot endorse the introduction of a tax upon capital gains of the magnitude suggested.

* If a taxpayer has acquired an asset six years before implementation and sold it four years after implementation for a profit of \$10,000, 6/10ths of the gain would not be taxable and 4/10ths (i.e. \$4,000) of the gain would be considered to have accrued after implementation date and to be taxable.

CORPORATIONS AND THEIR SHAREHOLDERS

The White Paper proposes that Canadian corporate and personal income taxes be integrated, either in whole or in part, by allowing recipients of dividends a credit that is related to the amount of corporate tax actually paid. We agree that it is highly desirable to continue some form of incentive to Canadians to invest in shares of Canadian corporations and that the present dividend tax credit requires modification to make it fairer. To this extent we welcome the Proposal, in this area, although we are not persuaded that the specific methods proposed are entirely acceptable or desirable. In particular, we are not convinced that the entire amount of corporate tax is really borne by shareholders except in a limited number of situations. Consequently, although complete integration is conceptually attractive, we are not prepared to endorse it at this time. To the extent that the tax is partially borne by shareholders, the proportion will vary according to the particular circumstances of the corporation so that any specific percentage selected will reflect a combination of the desired degree of incentive and a somewhat arbitrary allowance for that portion of corporate tax considered to be borne by shareholders.

We have also considered alternative measures, including an increase in the existing dividend tax credit or the deduction from corporate income of dividends paid, but, because of technical difficulties and inequities, cannot recommend them. We would be concerned about the introduction of a system that varies not only from the international norm, but also that departs so substantially from our present structure. Because we believe that incentives for Canadians to invest in Canadian shares are desirable and because some portion of the corporate tax is probably borne by shareholders we do recommend that a limited form of integration be adopted.

Widely-Held vs Closely-Held:

We are not satisfied that the proposed distinction between widely-held corporations and closely-held corporations is valid or defensible. The White Paper distinguishes between large publicly-owned corporations and small one-man businesses. If in fact such differences in size, method of operation, number of shareholders and competitive factors were the rule such a distinction might prove valid. However, most corporations probably fall somewhere between these two extremes and the substantial difference in tax treatment may cause anomalous results that, in many instances, cannot be defended.* Assuming a 50% personal income tax rate, the overall gain realized by a shareholder of a closely-held corporation will be taxed at 50% regardless of whether he obtains it by way of dividend, or by sale of shares, whereas the tax burden on a similar gain on widely-held corporations shares could range from 25% (if the entire gain is realized by sale of shares) to 62.5% (if the entire accretion is attributable to dividends from taxable profits). We are not satisfied that such a differential is defensible or acceptable.

* The classic comparison is that of "Eatons vs Simpsons" but there are many other cases where what, by definition, would be closely-held corporations compete directly with widely-held corporations, for example in the construction industry.

The different tax treatment proposed introduces a new dimension for shareholders of closely-held corporations in that the ultimate tax burden may be significantly different, depending upon whether or not they go public. Certainty is one of the major precepts for any tax system, but it cannot be achieved under the Proposals because it is not possible to determine in advance whether an ultimate increase in the value of a business will result from taxable earnings retained in the business or from goodwill gains. In most cases it would appear to be advantageous for most companies to be classified as closely-held until the owners wish to sell its shares. At that time, because of the 50% reduction in the amount of capital gain to be included in income, it would be advantageous to have the company classified as widely-held. However, this will not always be possible, particularly where shareholders wish to sell at different times or where a complete sale of all the shares is to be made to one purchaser. Furthermore converting a closely-held to a widely-held corporation too long in advance of a major sale of its shares could result in the shareholders being exposed to quinquennial revaluations and in a reduction of the corporation's creditable tax.

The distinction also creates a number of problems in the area of inter-corporate distributions that may prevent desirable corporate combinations or that will require complex relieving provisions. For example, dividends flowing from a widely-held corporation through a closely-held corporation and then to a widely-held corporation will bear an inappropriate burden of tax.* Similarly, capital gains realized by a corporation (other than a mutual fund or a corporation which elects to be taxed as a partnership) on shares of a widely-held corporation bear more tax than would be exigible if the shares were directly owned by individuals.

We do not believe that results such as described in the preceding paragraphs are appropriate or that a tax system should have such a profound influence on decisions or courses of action which should be made for business reasons alone. Because the stakes will be substantial, one can expect a large number of provisions designed solely to prevent the unwarranted use of the widely-held corporation capital gains provisions or, conversely, the closely-held full integration proposals. In these circumstances, one would look for a considerable amount of law, litigation and perhaps even Ministerial discretion which, in the final analysis, may be disrupting and will detract from the effective working of the new system.

* The following example shows the net after-tax effect to a shareholder in the 40% tax bracket after receiving a dividend from a widely-held corporation (WHC) direct, through a second WHC, and through a chain consisting of a closely-held corporation (CHC) and then a WHC

	Direct from WHC	Through a second WHC	Through a CHC and then WHC
Original dividend from a WHC			
fully covered by tax credits	400	400	400
Tax payable by second WHC		-	
Tax payable by CHC			(100)
Tax payable by WHC			-
Tax payable by shareholder	(40)	(40)	(30)
Net to shareholder	300	300	270

The most obvious method of removing some of these differentials would be to treat all corporations in the same way and we so recommend. The choice as to the appropriate degree of integration is not an easy one. We recognize that there are a number of theoretical and administrative advantages to complete integration such as elimination of the personal corporation legislation requirement and the identical treatment of all business income regardless of the form or organization, but for the reasons already given we are unable to recommend it. Because of our views on the proportion of corporate tax borne by shareholders, our belief that an incentive to Canadian ownership of Canadian shares is highly desirable, and in accordance with our views as to the level of taxation on capital gains, we think that it would be preferable to select a system of partial integration (based on credit for 50% of corporate tax paid) for the time being. The size of the credit could be extended at a later date if circumstances so warrant.

We have already indicated that we are opposed to the full taxation of gains realized over a long period of time and which, because of inflationary trends, will inevitably contain an element of illusory profit. It is also desirable, from a structural point of view, that there be some balance between realizing gains through a corporation by way of dividend and by way of sale of shares. In addition, a more beneficial rate of tax on gains on Canadian shares would also provide an incentive to invest in Canada. We therefore propose that all corporations be treated in the manner prescribed for widely-held corporations, namely that shareholders receive credit for half the corporate tax and that only half the gains realized upon the disposal of shares be included in income irrespective of the length of time owned.*

We recognize that our recommendations will continue to leave tax differentials between corporations and sole proprietorships and partnerships, but we suggest that there is, in general, a greater difference between these entities and a corporation than there is between a widely-held and a closely-held corporation. With the introduction of our proposals, some businesses which are presently carried on through the corporate framework might find it necessary to revert to sole proprietorship or partnership status in order to reduce the incidence of tax. We do not think that an incorporated proprietorship or partnership should be forced to give up limited liability solely for tax reasons and provision should be made to avoid this. We believe that this can be achieved by allowing those corporations that can do so to elect to be taxed as partnerships as recommended in the White Paper.

We therefore recommend that:

- (a) the distinction between widely-held and closely-held corporations be eliminated and that all corporations (save those eligible for partnership option treatment) be treated in the manner proposed for widely-held corporations. This would mean only one-half of Canadian share

* This inclusion in income of only half the gains on disposal of Canadian shares would not, of course, apply to traders or dealers.

gains would be included in income and shareholders would be given credit on dividends for one-half of the corporate tax paid;

- (b) the possibility of providing full integration be reviewed at some later date if it is found desirable to increase the incentive for investment in Canadian business.

Partnership Option:

We support the White Paper Proposals concerning the partnership option although the proposed conditions for eligibility seem to be too restrictive. In light of our preceding recommendations we suggest that the partnership election be retained in order that small companies which could operate as proprietorships or partnerships may continue to use the corporate form of organization.

The partnership option would be the equivalent of closely-held corporation status for small businesses and would provide a partial offset in some situations to the increased tax burden resulting from the removal of the low rate of corporate tax on the first \$35,000 of earnings. However, the partnership option cannot be fully effective until the top marginal rates of personal tax are reduced to approximately 50%. We have already recommended that the top marginal rates be reduced immediately for other reasons, but the reduction is also necessary to make the partnership option effective and useful immediately upon commencement of the new system.

The partnership option is also desirable within the corporate framework for subsidiary companies in order to partially obviate the need for consolidated returns.

The White Paper suggests that, where the partnership option is elected, the shareholders must value their shares in such a manner that inventory profits and the potential recapture of depreciation will remain taxable. Apparently the shareholders' equity in the business must be valued at cost or undepreciated cost and it would appear that no value may be ascribed to goodwill. This would have the effect of rendering goodwill in existence on valuation day taxable upon a subsequent sale. Similar, but not identical, provisions are suggested for closely-held corporations which do not elect to be treated as partnerships. As is discussed in paragraph E.8, we are opposed to the taxation of goodwill in existence on valuation day. Our recommendations regarding the treatment of goodwill (paragraph E.2) ought to alleviate this problem and we therefore suggest that the value of goodwill and other intangibles be taken into account in establishing the value of shares of partnership option corporations in the same manner as we recommend be allowed for partnerships and sole proprietorships. Under our proposals the need to make provision for non-creditable tax on introduction of the new system would be substantially reduced and would be restricted largely to recaptured depreciation, sale of oil properties, accrued gains in inventory and reserves permitted under Section 85B of the Income Tax Act.

The partnership election, if allowed on a broad basis, may result in a significant revenue leakage if shares are owned by registered pension funds and other tax-exempt entities because no tax would be col-

lected on the business income attributable to such shareholders. If this is considered undesirable, we suggest that the partnership election be denied where any shareholders are exempt from tax. Alternatively, provisions could be made to require all such corporations to allocate their income for tax purposes only amongst taxable Canadian individuals or corporations. This would allow such corporations to use the partnership election where tax-exempt shareholders were of minimal significance.

We therefore recommend that:

- (a) the partnership option be extended as a matter of course to wholly-owned subsidiary companies of Canadian corporations;
- (b) the option be allowed where non-resident shareholders undertake to file Canadian income tax returns reporting their Canadian source of income. Such an undertaking would also require non-resident corporate shareholders to pay the appropriate branch profits tax presently imposed under Section 110B;
- (c) the option be allowed where electing shareholders agree to assume the tax liability in respect of income allocable to a minority shareholder who does not agree to sign the election;
- (d) the requirement that corporate shareholders have the same fiscal year-end be eliminated where the corporate shareholder does not or cannot elect the partnership option;
- (e) the requirement that there be only one class of shares be removed where all of the other classes carry cumulative dividend rights.

Creditable Tax:

The integration concept, unlike the present dividend tax credit, introduces the principle that corporate tax must actually be paid before shareholders are entitled to a credit. We are prepared to accept this principle because any substantial increase in the present form of dividend tax credit either to provide additional incentive to Canadian ownership or as a somewhat arbitrary allowance in respect of underlying corporate tax would have serious revenue effects. However, it does create a number of situations that may result in shareholders being unfairly taxed and these situations should be corrected and these are discussed in the following paragraphs.

There will be cases where dividends must be paid out of earnings or gains which were not subject to tax and hence will not carry any creditable tax with them. In other circumstances there may be insufficient creditable tax to cover all of the dividend payments where there are different classes of shares. Situations may also arise where the payment of dividends, even in stock, is prohibited by virtue of covenants under trust deeds or by virtue of law with the result that shareholders

may lose the credit for the corporate tax.* Capital gains accrued prior to the implementation of the new system or non-taxable gains arising thereafter (proceeds of life insurance) will, if distributed, be subject to full tax.

In the mining industry and, to a lesser extent, in the real estate business, it is common and often necessary to pay dividends out of profits which have not borne tax because of depletion or capital cost allowances. To tax such distributions at full rates as ordinary income imposes an additional and unwarranted tax burden on shareholders and eliminates the incentive effect of such allowances, particularly in the extractive industries. This situation can be alleviated, even though not entirely corrected, by treating such dividends as capital gains.

We have noted the Proposal in the technical paper released by the Minister of Finance on 19 March 1970 that distributions not carrying creditable tax would be deemed to come out of the opening surplus and would be subject to the special 15% tax to be imposed upon such distributions. We commend this Proposal, but it will not solve all of the above problems because it will not apply to new companies nor will it assist those that have little or no opening surplus.

We have also noted the Proposal that the corporate tax for which credit may be claimed (creditable tax) must, in effect, be distributed within 2½ years from the end of the fiscal year to which it relates. We realize that such a rule would be necessary where credit may be claimed for the entire amount of corporate tax, but we do not believe that such a requirement remains where credit is to be given for one-half of the corporate tax only. It is unlikely that, under the system we propose, large amounts of creditable tax could be stored up which, if paid out at one time, would affect Government revenues. In fact, substantial payouts would probably increase Government revenues because of the additional tax payable by individual shareholders. Although we appreciate there are situations where accumulated creditable tax could become a problem (particularly in the case of corporations owned by non-residents) and could be abused, we believe these possibilities could be eliminated by specific legislation. Whatever the details of the necessary legislation, it should be directed at denying the purchasing shareholder the credit otherwise available where control (or a fairly substantial holding) of the corporation has been acquired by the shareholder and a dividend is paid out of pre-acquisition surplus.

In the early years of the system, the 2½-year distribution rule would impose an additional burden of tax on shareholders whose marginal rates of tax were in excess of 50%. We have already recommended** that all marginal rates in excess of 50% be eliminated immediately on introduction of the proposed system. If this recommendation is not

* For example, Section 105 of the Canadian and British Insurance Companies Act provides that an insurance company, subject to a few exceptions, "shall not in any particular calendar year declare dividends to shareholders the aggregate amount of which exceeds seventy-five per cent of average annual profits of the company, for the three calendar years preceding that particular calendar year".

** Paragraph B.23

accepted the efficiency of the system will be impaired and an unfair tax burden will result so that the $2\frac{1}{2}$ -year rule must be eliminated or extended.

We are convinced that a series of special rules will be required to deal with creditable tax and corporate distributions and we therefore recommend that:

- (a) the Proposal whereby distributions that do not carry creditable tax be deemed to come out of opening surplus be retained;^{*}
- (b) special distribution rules be enacted whereby distributions that do not carry creditable tax with them as a result of depletion, capital cost allowances or non-taxable gains
 - (i) be treated as capital gains for individual or portfolio shareholders to the extent that the opening surplus is non-existent or has been exhausted;
 - (ii) be deemed to reduce the cost basis of the shares for direct corporate investors;
- (c) rules be established to determine which classes of shares are entitled to creditable tax in the event of there being an insufficiency. The entitlement to creditable tax could be the same as the order of priority upon dissolution of the corporation, although, depending upon the desired degree of incentive, it may be necessary, to introduce rules to prevent all of the creditable tax flowing to Canadian shareholders where there is a substantial non-resident interest in the company;
- (d) the $2\frac{1}{2}$ -year distribution rule should be abandoned. Provisions may be necessary to deny the credit in the hands of receiving shareholders who have acquired a company and have withdrawn surplus on hand at the time of acquisition.^{**} If the $2\frac{1}{2}$ -year rule is not withdrawn and if the top marginal rates of personal tax are not reduced to approximately 50% immediately, then we would recommend that the time limit for utilization of creditable tax be lengthened during the transitional period to coincide with the final reduction of the top personal tax rates.

Low Rate of Corporate Tax:

There has been substantial opposition to the removal of the low corporate rate of 21% on the first \$35,000. of taxable profits. We do not believe it necessary to reiterate all of the arguments in favour of the low rate other than to say that an extremely good case can be made for some temporary tax alleviation or postponement for new small businesses. These businesses are vital to the economy of Canada and their need of funds for growth and expansion, let alone just starting up, coupled with their inability to borrow funds from outside sources requires some special pro-

^{*} Paragraph D.38

^{**} In this connection, it would be desirable that some form of advance ruling procedure be instituted so that credit is not automatically denied in respect of desirable corporate reorganizations or acquisitions.

visions. Although the low rate has alleviated these problems, it is perhaps not the most efficient method of providing assistance. We do not believe that it should be available in respect of earnings which are not retained in the business, nor do we believe that it should be available to all corporations. Accordingly, we accept the Proposal to remove the low rate of tax over a four-year period, but we must strongly advocate that alternative forms of assistance be provided for small businesses. There are many ways in which this can be done and they will have varying degrees of merit and difficulty. The need for assistance will be even more necessary if our recommendation to treat all corporations as widely-held is adopted.

We realize that almost any form of tax relief requires the maintenance of associated corporation provisions or similar legislation. Although we would like to see such provisions disappear, relief or deferment for new businesses is far more important than the administrative difficulty of associated corporation provisions. We must therefore accept the necessity of retaining associated corporation provisions if necessary.

We strongly recommend that some alternative assistance or incentive be provided for new small businesses and that consideration be given to one or more of the following: *

- (a) accelerated capital cost allowances for new small businesses, whether incorporated or not, along the lines recommended in the Report of the Royal Commission on Taxation; **
- (b) modification of the capital cost allowance system to allow every small business to write-off completely the first (say) \$15,000 spent in each year on capital assets until it ceases to be small enough to require this advantage. Unused allowances should be available for carry-forward;
- (c) instituting a special allowance or deduction from taxable income for small business related to increases in working capital and fixed assets. Such allowance might be patterned after the existing allowance for increases in capital investment for determining the branch profits tax under Section 110B and might simply provide for a deduction (subject to an annual overall maximum) of some percentage of the net increase in specified items of working capital and undepreciated capital cost of fixed assets. Where a net decrease occurs, the same percentage of the decrease would be added to taxable income;
- (d) postponing the payment of the additional corporate tax

* All of the provincial Institutes thought that if the low rate of corporate tax is withdrawn it was imperative that alternate assistance be provided to small businesses. Some expressed the opinion that our recommendations did not go far enough.

** Volume 4, pages 267-282. In summary, these provisions would allow the write-off, to the extent of profits, of \$250,000 of capital cost without regard to the maximum rates of capital cost allowance for businesses whose assets were less than \$1 million and whose gross revenues were less than \$10 million if the business was owned, to the extent of 70% or more, by Canadian individuals who did not have or had not had investments of 30% or more in other qualified businesses.

arising from the removal of the low rate for a ten-year period, to the extent that the funds are retained and invested in the business.

Mutual Funds:

The Proposals for taxation of mutual funds and real estate trusts appear to be neither appropriate nor acceptable bearing in mind the purposes for which they are formed and used. While the Proposals attempt to equate the position of a mutual fund shareholder with the position of a direct investor, we are not satisfied that this can be accomplished for those shareholders who sell or redeem shares during the year. We also understand that there is a significant volume of non-resident investment in Canadian mutual and real estate funds which will be adversely affected by the Proposals. We believe that this type of foreign investment is good for Canada and it would be singularly unfortunate if it was repatriated solely because of adverse tax consequences which can easily be corrected.

In addition, we understand that a large number of pension funds and registered retirement savings plans invest their money through mutual funds. Because these entities are exempt from tax, but will not be entitled to credits for corporate tax they will be forced to avoid mutual funds because capital gains, interest and foreign dividends that would not be taxed if received directly by the pension or savings fund would be taxed in the mutual fund. We believe this to be most undesirable. All of the adverse effects mentioned could be easily corrected by treating all mutual funds and similar types of organizations, be they incorporated or not, as trusts or agencies that are required to distribute or allocate all of their income annually.* We can see no reason why this should not apply.

We therefore recommend that:

- (a) mutual funds, real estate unit trusts and similar investment entities, whether incorporated or not, be permitted to elect to be treated as trusts or agencies and thereby entitled to allocate their total income annually amongst shareholders or unit-holders; **
- (b) where a qualifying mutual fund is a shareholder of a corporation, that corporation would be prohibited from electing to be taxed as a partnership.

Public Utilities:

The Proposals for public utilities will severely affect the position of their shareholders. In our view, the tax paid by these uti-

* We recognize that this treatment would not be suitable for investments by mutual funds in companies which elected to be taxed as partnerships because there would be no loss of credit for one-half of the corporate tax which should be imposed where the shares are widely-held, but this situation could be corrected by denying the partnership election where one or more shareholders are mutual funds, as defined, or by prohibiting such funds from investing in partnership election corporations.

** Some provision would be required for payment of withholding tax on allocations to non-residents.

lities should be treated as creditable tax even if the Federal Government remits 100% of the tax to the provinces. The remission of utility taxes to the provinces may well be desirable for a number of reasons, but this does not mean that such corporations do not pay Federal tax any more than it can be said that ordinary corporations do not pay Federal tax because a portion of such taxes are turned over to the provinces through grants, equalization payments or shared-cost programmes.

We therefore recommend that public utilities be treated in the same manner as other corporations.

Non-Creditable Tax:

We have noted the Proposal to establish non-creditable tax on the potential recapture of depreciation contained in the White Paper and the amplification contained in the technical paper dated 19 March 1970 that extends this concept to include the goodwill element in company share valuations. The necessity for such rules will be lessened in the light of our recommendations concerning the tax treatment of goodwill and corporations. In addition, the necessity would be eliminated entirely where the time apportionment formula was adopted for the valuation of shares of unlisted companies.

We are fully aware of the potential revenue losses from the overvaluation of assets, the problems involved in establishing realistic valuations and other transitional problems. However, as pointed out in paragraph C.39, it is highly desirable that generous valuation procedures be adopted to make the introduction of capital gains taxation as easy and workable as possible.

The Proposal whereby non-creditable tax is to be collected upon amounts of income equal to the goodwill element contained in the share valuation of closely-held companies cannot win public acceptance, no matter how justifiable it might be. Shareholders of companies listed on a stock exchange will be allowed to include sizeable elements of goodwill in the valuation of their shares (if the market so values them) and it appears to be completely discriminatory to effectively deny the inclusion of goodwill in the case of unlisted share valuations or, as proposed, to impose additional tax where goodwill is included.

Our recommendations that only half of the corporate tax be available as a credit in the hands of shareholders and that goodwill be treated as a non-depreciable asset (paragraph E.8) will, we believe, reduce the necessity to cancel otherwise creditable tax. While it may still be necessary to make special provision with respect to the recapture of depreciation, sale of oil rights, the realization of special reserves (such as are allowed under Section 85B) and accrued inventory profits, we believe that the non-creditable tax in such situations should be collected out of the tax payable upon realization of these profits rather than from the tax payable on other profits.

We therefore conclude that the Proposals with respect to the collection of non-creditable tax may be unnecessary and that, where situations seem to require such treatment, alternative measures should be explored. Transitional provisions or valuation rules should be designed merely to protect the revenue and not to collect tax. We believe that

they should be carefully considered and should not penalize the many simply to overcome some potential advantage to a few. In this area more than any other we believe that the Government must be generous and even prepared to suffer some loss of revenue.

We therefore recommend that:

- (a) the Proposal that otherwise creditable tax be cancelled in anticipation of the event it is intended to guard against be abandoned and other solutions be sought;
- (b) where cancellation of otherwise creditable tax is necessary it should only be applied when the profit is realized.

Pre-System Surplus:

The White Paper indicates that surplus accumulated prior to the introduction of the new system may be distributed tax-free if the corporation pays a special 15% tax thereon. We agree that this is a highly desirable Proposal. However, additional tax may be incurred when shares are valued on the basis of earnings, and the distribution is not of sufficient magnitude to lower the share price. Problems may also be encountered in assuring that capital gains and other items of surplus which are not included in undistributed income can be paid out without the incidence of further tax.

We therefore recommend that:

- (a) pre-system undistributed income be allowed to be distributed in its entirety to shareholders free of tax upon payment of a special 15% tax by the corporation, but that the tax not be applied to realized capital gains included in retained earnings, so that they could subsequently be paid out as a return of capital;
- (b) the above option be made available immediately so that distributions of this nature could be made before valuation day.

Quinquennial Revaluations:

We are aware of the basic philosophy underlying the Proposal to revalue shares of widely-held corporations every five years, but we are completely opposed to it. Revaluation every five years will have serious adverse affects upon control blocks, shares held in escrow and on non-resident holders of substantial interests. We believe that the imposition of the tax in the latter case substantially negates the effect of the reduced rate of non-resident withholding tax provided as an incentive to make shares of Canadian subsidiaries of foreign corporations available to Canadians. The revaluation proposal will also have unfortunate implications in the case of portfolio investors holding shares as a hedge against inflation. The taxing of temporary market gains could produce unfair results in that tax might be paid on gains that are never realized. Undoubtedly, the Government is aware of some of these problems, but we cannot state too strongly that the Proposal is not acceptable. We recognize that the elimination of this Proposal might require some tightening of the proposed rules for tax-free corporate roll-overs, a deemed realization of all gains upon death and, per-

haps, a restriction upon the deductibility of capital losses. As already stated in Section C, we are quite prepared to accept reasonable conditions along these lines.

If the quinquennial revaluation Proposal is abandoned, taxpayers will tend to realize losses early and to postpone gains for as long as possible. It is therefore necessary to introduce some restriction upon the deductibility of losses but such restriction should apply only to corporation shares.*

Apart from shares, we are very much opposed to any Proposal which would severely limit the deduction of capital losses. If gains are to be taxed, then losses should be allowed and the time of the loss is the time when relief is needed most. The only possible justification for the denial of deduction for realized capital losses is where the taxpayer has unrealized capital gains which exceed the realized losses.

We therefore recommend that:

- (a) the quinquennial revaluation Proposal be completely abandoned;
- (b) the "roll-over" treatment proposed for corporate reorganizations be made consistent with our recommendations contained in paragraph D.51;
- (c) the restriction on the deductibility of capital losses, if any, be confined to situations where a taxpayer has unrealized capital gains in excess of the losses on share investments as outlined in paragraph C.16;
- (d) unrealized gains at death be subject to tax as outlined in paragraph C.8.

Intercorporate Transactions:

The Proposals contained in the White Paper indicate that a distinct tax penalty is imposed where a widely-held corporation other than a mutual fund, or a closely-held corporation that cannot avail itself of the partnership election, realizes capital gains on the disposal or revaluation of widely-held corporation shares. While our proposals with respect to corporations call for the loss of half the corporate tax paid on earnings and gains, we do not believe that additional tax penalties should be incurred because a corporation realizes capital gains. Accordingly, we suggest that consideration be given to the provision of rules to allow corporations to make special distributions from realized capital gains that would be treated as a capital gain to shareholders rather than a distribution of earnings.

In some situations it is necessary or desirable for non-residents to hold shares in a Canadian public company through the medium of a wholly-owned Canadian subsidiary. The Proposals contained in the White Paper would require the subsidiary company to pay an additional 25% tax on dividends received from the public company whereas no similar tax would be exigible if the shares were owned by a non-resident directly. We do not believe that such a result should prevail. If all corporations

* Our detailed recommendations as to treatment of losses are set out in paragraph C.16.

were treated alike as we suggest, this problem would not arise, but, in the absence of such treatment, special rules would be required in order to avoid this unintended consequence.

Problems will also arise where dividends are paid from one corporation to another under circumstances where there is insufficient creditable tax. We do not believe that dividends from direct investments that remain within the corporate framework should be subject to additional corporate taxes, except in some cases where they are paid out of surplus existing at the time of acquisition. Our recommendation at paragraph D.24^{*} relating to creditable tax may be the answer to most of these problems, but we raise it again here so that it is not overlooked.

Our recommendations with respect to the tax treatment of all corporations will, because full credit will not be given for the corporate tax, encourage individuals to transfer their investment portfolios to corporations which do not elect the partnership option. This will have the effect of postponing the additional tax that should be paid and will therefore require legislation similar to that presently applicable to personal corporations to offset the tax deferral that would otherwise be available. This could be accomplished by modifying and improving the existing personal corporation legislation or by imposing a special tax^{**} upon the income of such corporations derived from dividends from Canadian corporations which were not distributed to shareholders.

We therefore recommend that:

- (a) special capital gain distribution rules be established for all corporations so that such gains can be distributed without further tax to the shareholder;
- (b) special rules be prescribed for corporations in the personal corporation category including, if necessary, a tax on net dividends from Canadian corporations;
- (c) if our proposals concerning the tax treatment of corporations are not accepted, then we recommend that the whole area of intercorporate dividend flows be reconsidered and modified so that the anomalies we have noted are removed.

Reorganizations:

We are in general agreement with the Proposals contained in the White Paper concerning tax-free roll-overs. However, to the extent that the capital gain treatment of shares of corporations and other assets is equated, it might be possible to allow tax-free roll-overs where assets are contributed to widely-held corporations as well as where they are contributed to closely-held corporations.

We appreciate the fact that the quinquennial revaluation rule would permit a relaxation of the deemed realization rules with respect

* For direct corporate investors dividends received that do not carry creditable tax would be deemed to reduce the cost basis of the shares.

** In the case of dividends carrying creditable tax, a rate of 16-2/3% on the grossed-up dividend would serve the purpose.

to the shares of widely-held corporations and that some of these rules would have to be stiffened if the quinquennial revaluation Proposal were abandoned. We do believe, however, that where a shareholder enters into an exchange transaction which does not sever his "substantial economic interest" in the new entity, a tax-free roll-over should be granted. In many cases this is desirable from an economic point of view and we would be alarmed if tax barriers were erected against the rationalization of industry. It is not possible to spell out the many types of transactions that may be involved in corporate reorganizations, but we believe quite strongly that a number of such transactions should be spelled-out in the legislation, delineating those that are automatically taxable and those that are to be granted roll-over treatment. In the grey area between, we are of the view that the Minister of National Revenue should be provided with limited discretionary powers which he would be required to exercise promptly upon application and in advance of the transaction. This would require a system of binding advance rulings.

We therefore recommend that:

- (a) legislation be enacted to provide for the automatic exemption from deemed realization where there is no substantial change in economic interest and, conversely, that deemed realizations be provided for where a shareholder is effectively relinquishing or giving-up a real interest in the business that he formerly controlled;
- (b) a system of binding advance rulings be instituted for those reorganizations, amalgamations, etc. which are not specifically covered in the law. The legislation should be so worded that denial of a favourable ruling would have to be accompanied by a conclusion, rather than a suspicion, that the transaction was being consummated for the purpose of avoiding income tax and was not motivated primarily by proper business reasons or economic interests.

BUSINESS AND PROPERTY INCOME

We agree with the statement in the White Paper that by and large, the present system of determining business income which is based, for the most part, on commercial and accounting principles and practice, is satisfactory and does not require any radical change. Some of the proposed changes have been advocated by us in the past and we welcome them.

Goodwill:

For many years, taxpayers have been unable to deduct various legitimate business expenditures which represented capital outlays not eligible for capital cost allowances (the so-called "nothings"). The Proposal to permit such costs to be included in a special new class bearing depreciation at a rate of 10% is welcome. We have, however, serious reservations about the inclusion of goodwill in this category.

In its Brief to the Royal Commission in 1963, the CICA recommended that those expenditures described as "nothings" ought to be either deductible or depreciable, but it excluded from this category expenditures in respect of land, securities and goodwill.

The Report of the Royal Commission discussed the question at some length and concluded that "the cost of purchased goodwill, or other intangible assets of indefinite life, would be deductible upon disposition or upon an established, significant loss in value".^{*} The Commissioners reached their conclusion on the basis of a number of factors. While recognizing that goodwill will gradually disappear unless it is maintained, they noted that maintenance costs were deductible and the value of goodwill generally does not depreciate. They also thought that to permit the amortization of goodwill when there was no demonstrated decline in value would tend to create a tax incentive to business take-overs. Furthermore, they recognized that the deductibility of goodwill would give rise to an advantage resulting from the increasing value of goodwill as a result of its deductibility. The White Paper Proposals attempt to overcome this latter fault but they will create other and more difficult problems.

The decision to allow depreciation in respect of goodwill results in some severe complications at the time of the switchover from the present system under which goodwill is not deductible. Although goodwill is not the only factor involved in the non-creditable tax problem discussed in the previous section, it creates the major part of the difficulty.

The problems surrounding the deduction of goodwill in the case of unincorporated businesses and some closely-held companies is also a matter of great concern; we believe that the administrative difficulties have not been adequately thought out. There are a number

* Volume 4, page 284 - Report of the Royal Commission on Taxation.

of unincorporated professional partnerships in which partnership interests are transferred at prices which include goodwill valued on a formula basis and the partnership agreement or contract which sets the value of goodwill cannot be adjusted easily to take account of the tax impact. The proposed change in the tax treatment of goodwill could therefore work unfairly. In addition, we assume that under the Proposals, each partner could amortize his portion of purchased goodwill in computing his income. Because in growing firms partnership interests are adjusted on almost an annual basis, the difficulties for partners in keeping track of goodwill would be quite substantial.

In the case of many incorporated professional or personal service firms, share-interests are treated in almost the same way as partnership interests and again, are adjusted on a regular basis between the "partners". Here, the goodwill element in the price would not be depreciable even though that price also recognized goodwill--again generally computed on a formula basis. The Proposals suggest that goodwill recognized in the purchase price of shares would become depreciable by the simple expedient of winding up the purchased company and attributing it to the assets and values established by the cost of the shares. It is not realistic to assume that corporations can be wound up and values ascribed to the assets each time a change in the interest of the "partners" takes place. Again the inability to adjust contracts providing for valuation of goodwill could have unfair results.

In addition to the difficulties created by the introduction of goodwill as a depreciable item, we also note that the Proposal requires that an increasing proportion of the proceeds of goodwill be included in income between the first and thirteenth year of the new system. This will result in retroactive taxation for existing goodwill. The White Paper makes the point that goodwill, unless maintained, will disappear and that it is maintained only by deductible expenditures. We do not agree that goodwill necessarily results from deductible expenditures made in connection with a business. In any event, the proposal to include increasing amounts of the proceeds of disposition of goodwill in income without allowing any deduction for the goodwill existing at implementation date which under the Government's theory must be disappearing is unfortunate.* In the case of land, for example, gains will be taxable but losses will be deductible. It seems unreasonable to discriminate against goodwill in this way.

We strongly recommend that goodwill should be excluded from any class of depreciable asset and should be treated in the same way as land. Because it is difficult to distinguish between the value of goodwill and long-term contracts, licences or franchises for unlimited periods, it is our view that

* For example, if goodwill in existence at implementation date has a value of \$100,000 and is subsequently sold for \$10,000 no loss will be recognized. In fact the vendor will be taxed on some portion of the \$10,000.

these latter items should be treated similarly. Contracts and franchises, etc. for limited periods, however, should be depreciable as at present.

Entertainment and Related Expenses:

The Government has stated in the White Paper that it "believes that provision should be made for deduction of legitimate business expenses" but also believes that certain types of expenditures should be expected to be met out of tax-paid income. It therefore proposes to deny deduction for entertainment expenses, the costs of attending or sending employees to conventions, and the cost of dues for membership in social or recreational clubs. We see no justification for the Proposal that entertainment and convention expenses should be treated differently from other business expenses nor that they should be met out of tax-paid income. We can only infer that these expenditures are not considered to be legitimate business expenses, but rather some tainted category of expense that relates more to personal enjoyment than to business purpose.

We believe that it is unreasonable to grant a standard employment expense deduction to employees whether or not they incur expenses while at the same time denying the deduction of a legitimate expense to persons who do in fact incur them.* Perhaps one of the unstated reasons for the arbitrary Proposal to disallow entertainment expenses is the difficulty in determining whether such costs are a proper business expense. In our view it is possible and desirable to require that expenses be properly substantiated. Persons claiming such expenses should be prepared to prove the amount and maintain a written record as to the business nature of the expenditure on penalty of automatic disallowance.** If this was required there would be no reason for a blanket disallowance of entertainment and convention expenses. To the extent that an employee was unable to substantiate expenses reimbursed by an employer the reimbursement should be regarded as remuneration.

We view the proposed denial of deduction for the costs of entertaining at business meetings and club memberships, etc. as imposing a serious hardship on professional persons who are prohibited from advertising their services and on persons for whom advertising is an uneconomical method of obtaining business. One major way in which such persons obtain business is through community contact and one common way to achieve this contact is by membership in social or recreational clubs. In our view, these costs, should be deductible.

We have considered whether some distinction ought to be drawn between what may be described as "downtown businessmen's clubs"

* We have earlier recommended in paragraph B.39 that the allowance for employment expenses be modified to permit a more generous deduction for proven outlays.

** The record could show names of persons entertained and their business relationship.

including Boards of Trade, Chambers of Commerce, etc. and recreational clubs such as golf clubs, curling clubs, etc. We have concluded that no distinction should be drawn because in many communities the only clubs available would be classified as recreational clubs. We do think, however, that there is some justification for disallowing as a deduction, some portion of the membership costs of any club where substantial use of the facilities for business purposes cannot be clearly demonstrated.

In our view, the deduction of entertainment expenses generally is not abused by the business community although we recognize there are a few cases where attempts have been made to deduct entertainment or other expenses which are clearly of a personal nature. We believe that lavish entertainment and the use of yachts, hunting and fishing lodges, etc. ought to be discouraged and that personal expenses should not be deducted. There are, however, adequate provisions in the present Income Tax Act to overcome such abuses and we believe it is neither necessary nor desirable to prohibit arbitrarily the deduction of adequately substantiated business expenses to catch the few who may be cheating.

Although abuses of expense accounts, lavish entertaining and the like are by no means confined to the business community, we note the Proposals are exclusively directed at a disallowance of such costs to the employer. We can see no reason to disallow the expenses to an employer but where an expense can be identified as being incurred to confer a benefit on an employee, it should be treated as a benefit to the employee. Such a procedure would maintain parity between persons in business as proprietors, employees of business organizations and employees of governments and other non-taxable institutions.

We also believe that costs of sending employees, or a self-employed person attending a business convention,^{*} should be deductible, so long as the convention has a substantial technical programme and is held in the region in which the members of the association or group reside, for example--a trade association whose members are located in metropolitan Montreal should not hold their convention or meeting in Vancouver or Banff but, rather in the vicinity of Montreal. Similarly, where a convention is national in character, the expenses should be deductible only if it is held in Canada.

Many Canadians are members of professions or associations whose concerns cross international borders. We think that it is to Canada's advantage that Canadians should participate in international forums to promote Canada's viewpoint abroad. For this reason, we think that participation by Canadians in conventions or meetings of international organizations where the meeting is held outside Canada should also be deductible.

While the travelling expenses of wives going to meetings and conventions with their husbands have generally been disallowed in the past, there have been one or two cases in recent years where the Courts have ruled that the wives' costs in attending a meeting or convention with their husbands have been deductible. There are a few situations where there may be a legitimate business purpose served by the attendance of

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We have assumed that the expression "convention" as used in the White Paper is not intended to include educational courses.

of wives at business meetings and conventions but it is difficult to define clearly the conditions under which such costs should not be treated as a benefit to the husband. For certainty and uniformity, we believe that the law should be clear on this point. We would reluctantly accept the cost of a wife attending a convention with her husband being included in the husband's income as a benefit.* The cost should however be deductible to the employer.

In summary, we recommend that:

- (a) properly substantiated and reasonable entertainment costs (including memberships in clubs used for business purposes) continue to be deductible;
- (b) the costs of unreasonable entertainment, use of yachts, travel of wives and unsubstantiated expenses should be deductible to the employer but should be taxed in the hands of the employee or other person enjoying the benefit;
- (c) the costs of attending business or professional conventions or meetings should be deductible provided the meeting is within the general geographic area covered by the organization sponsoring the meeting.

Depreciation:

The main thrust of the Proposals for changes in the capital cost allowance system is to close certain loopholes that appear to exist in the present tax structure. We do not disagree in principle with the three Proposals, namely:

- (a) that the present tax-free write-up in the depreciable value of assets when the owner dies should be eliminated;
- (b) that taxpayers would not be permitted to deduct against other income losses from holding rental property if the loss was created by capital cost allowance, and
- (c) that a separate depreciation class be created for each rental building costing \$50,000 or more.

We have earlier recommended that for purposes of a tax on capital gains, the accrued capital gain** on property should be taxed at the time of a taxpayer's death. Both the undepreciated capital cost and the capital cost of the property should be increased by the amount of the accrued capital gains included in the deceased's income.

The Proposal that a loss on rental properties created by capital cost allowance would not be deductible from other income makes no mention of loss carry-forward or back. We assume that such a loss would be available for carry-back one year and forward for five years against income from rental property in those years. If this is not the intention, the Proposal would work unfairly in situations where a taxpayer

* Obviously this would have no application where the wife was attending the convention in her own right. For example, where both husband and wife were employed teachers and both attended an educational convention at the cost of the employing educational authority, this rule would not apply.

** We emphasize that we are referring to the capital gain element only. We do not suggest that capital cost allowance should be recaptured at death.

had extraordinary maintenance or other current costs in connection with rental property in one year.

The Proposal appears to be directed at the use of rental property as a tax shelter and, to this extent, it is acceptable. However, it should not operate to prevent a taxpayer whose principal business is the holding of property for rental purposes, from deducting rental losses against other income he may have. For example, a real estate development company should not be prevented from offsetting a loss on its rental operations from income which it obtained through managing other person's property. We believe that a principal business test would be relatively simple to administer and should be included.

There are a number of cases where rental operations are an integral part of a larger business operation, for example--the rental of service stations by an integrated oil company. The rental of this type of property may never be profitable in itself but is justified by the use to which the property is put to gain income in other ways. In such cases, the losses occasioned by the claiming of capital cost allowance on the rental properties, should clearly be deductible from the other other income.

The White Paper also proposes to restrict the deductibility of losses arising from holding property, if the losses resulted from the deduction of interest or property taxes. While we agree that deduction of a loss occasioned by claiming capital cost allowance should not be permitted to reduce other income where a taxpayer is using the property as a tax shelter, we believe that different rules should apply in the case of interest and property taxes which represent a cash outlay and a normally deductible expense. The White Paper notes that taxpayers might, but for such a provision, be able to reduce or eliminate tax on their current incomes by holding large amounts of speculative property. Since the payment of interest and property taxes represents a real outflow of cash, it seems to us proper that a taxpayer should be entitled to a current deduction. Any gain derived from the sale of such property should ultimately be fully taxable and we cannot see that the costs of holding such property should be any less deductible than the financial costs of carrying the inventory of any other kind of business.

Although the White Paper is not specific, it appears that the Government intends to remove some of the current restrictions on the deduction of interest costs connected with the purchase of shares of corporations. This will enable Canadian companies to be more competitive against foreign bidders for the shares of other Canadian companies and we endorse such a proposal.

We recommend that the Government's Proposals in the area of depreciation and carrying charges be modified to:

- (a) increase the undepreciated capital cost and capital cost of property by the amount of any capital gain accrued at the death of the owner;
- (b) permit the deduction of all property losses from any other income where the principal business of the person suffering the loss is the rental of property;
- (c) permit the deduction of rental losses where rental opera-

- tions are an integral part of a larger business operation;
- (d) permit the deduction of carrying charges against other income where the carrying charge is related to rental property.

Natural Resource Industries:*

The mining, petroleum and natural gas industries have, over a number of years, provided a significant economic impetus for Canada. We believe that their growth has been fostered by certain incentives granted in the past and that the withdrawal of these incentives may reduce substantially their future rate of growth. It is our view that taxes in these industries should be comparable with taxes in other countries with whom Canada competes for investment in the natural resource industries both in the Canadian capital market and in the international capital markets. We understand that various corporations and groups within the industry will be making submissions to your Committee and we believe they will deal with this aspect in detail. Accordingly, we are confining our remarks to certain specific areas of the Proposals that appear to create anomalies and inequities.

For many years there has been a controversy over the appropriate treatment to be given to provincial mining taxes. These taxes are, in effect, an income tax imposed by the provinces on mineral profits of mining companies. The Government has, however, treated these taxes as if they were royalties and hence expenses. It is our view that these taxes should properly be regarded as an income tax and should be taken into account in determining the total weight of taxation borne by mining companies. If the Proposals were adopted and the treatment of provincial mining taxes is not modified, it is our view that mining corporations could be taxed more heavily in Canada than in other countries and more heavily than manufacturing companies in Canada. We believe that, in revising the tax structure applicable to the mining industry, the provincial mining taxes should be taken into consideration, perhaps by setting a different and lower rate of tax on mineral profits.

The Proposal to grant depletion allowances to companies that earn them by carrying out further exploration creates a number of difficulties. Perhaps, the most obvious is that under the integration system the incentive would in effect be recaptured at the time dividends are paid to a Canadian recipient, because a corporation that had claimed depletion allowances would bear less tax than one not in a position to claim depletion. As a result on the full pay-out of its surplus, not all of the dividend would carry creditable tax and additional tax would be payable by a shareholder. While it may be argued that few large mining companies pay dividends at a rate sufficient to exhaust the available creditable tax, there are a number of situations in which substantial dividends are indeed paid, particularly to parent companies to enable the parent to meet debt obligations.

There will be a difference between the treatment of incentives

* Some provincial Institutes, while sharing the concern expressed herein about the sharp cutback in resource incentives, were further of the opinion that the present resource incentives should be retained unchanged.

where the partnership option is elected or where the depletion is granted to an individual as opposed to a corporation.* In addition, it is also worth noting that because non-resident shareholders would not be affected by the integration Proposal, they would obtain the benefit of depletion whereas Canadian resident shareholders would, in effect, suffer recapture of any depletion allowances distributed to them by way of dividends.

Our recommendations in paragraph D.2) concerning dividends not covered by creditable tax would largely alleviate these problems but do not provide a completely acceptable solution because we believe some benefit from the incentives should pass through to shareholders.

There are two transitional problems that particularly concern us. The first of these relates to the withdrawal of non-operators' depletion allowances. It has been traditional in the oil industry to sell royalty interests in oil properties (and to a lesser extent there are similar mining royalties). Consequently, there are many persons who now receive income in the form of royalties which are eligible for a 25% depletion allowance. In most cases these royalty rights have been acquired in the expectation that depletion would continue to be granted on them. We think that the holder of a royalty right or certificate who held his right or certificate on or before 7 November 1969, should be permitted some continuing claim for depletion.

It is also proposed that the present operators' depletion allowances should be continued until at least 1976 at which time the new system of earned depletion** would take its place but this transitional provision would, however, be available only to taxpayers who owned the mineral resource on 7 November 1969. Where a taxpayer acquired a mineral resource after that time, depletion allowances would be available under the new system only to the extent they had been earned. It has been common practice in the extractive industries (mining, oil and gas) to maintain mineral properties in separate corporations and, particularly in the oil industry, many of these corporations are wholly-owned subsidiaries of a parent company. We believe that the present depletion allowances should be continued during the first five years of the system as is proposed in the White Paper even in those cases where the mineral resource becomes owned by another company so long as the transactions take place not at arm's-length. Safeguards would be required to prevent one corporation being sold to another before being wound up but we believe that reorganizations within a single corporate group should be permitted without losing the benefit of the transitional depletion allowances. We also think that there should be provisions to transfer the right to claim earned depletion within a related group.

We recommend that the Proposals affecting the natural resource industries be reconsidered to ensure that Canada's

* In either of these situations, the depletion allowance will not be subject to tax whereas, if received through a corporation that cannot elect the partnership option, the allowance will be taxed.

** Under the new system proposed, the amount of depletion allowance available would be related to the amount of exploration activity undertaken.

tax on these industries is not substantially higher than taxes imposed by other countries with whom we compete for resource investment funds. We also recommend that:

- (a) the tax structure take proper recognition of provincial mining taxes;
- (b) provision be made for some flow-through of depletion incentives to Canadian shareholders;
- (c) non-operators' depletion be continued with respect to existing royalty agreements or amortization of value on valuation day be permitted, and
- (d) provision be made to avoid loss of both earned and unearned depletion as a result of corporate reorganizations.

Taxpayers in the Professions:

The White Paper proposes that taxpayers in the professions be required to compute their income for tax purposes on the accrual basis rather than on the cash basis presently permitted. The Government stated that it believes that the tax postponement permitted by the concession of computing income on a cash basis has given professionals an unwarranted advantage by comparison to the rest of Canadians. We do not agree that there has been an unwarranted advantage given to professionals, because the vast majority of Canadian taxpayers are wage earners and in fact, account for their income on a cash basis even though other benefits are accruing to them. Employees also have other advantages under the income tax structure which are not available to most persons carrying on professions. Some of these benefits include the ability to obtain non-taxable group life insurance and disability insurance, employers' pension plans, etc.

Even if the Proposal to tax professionals on an accrual basis were fair and equitable, it overlooks certain grave difficulties in its implementation. Of these by far the most serious is the difficulty of valuing the inventory of a professional business. For the most part this inventory consists of an accumulation of time by the proprietor, partners and staff that may not be capable of being billed at the year-end of the professional firm. In many cases the value of the work done to that point cannot be determined. While it may be possible to determine the cost of the work, if adequate time records are kept, by reference to the salary paid to the person actually doing the work (where the work is done by an employee), the cost may have little relationship to the value of the work done. In many cases the inventory has no value until such time as the work is completed to the client's satisfaction. In any event, it should be noted that many professional persons do not maintain, and some cannot reasonably be expected to maintain, time or other records that would enable any meaningful determination of work in process.

Even if the Proposal to tax professionals on the accrual basis is enacted, we believe the transitional provisions proposed are inadequate. Briefly stated, the Proposal is that the opening balance of unbilled work and accounts receivable, would not be brought into income immediately but rather would be brought into income over a period of time by computing the taxable professional income as the greater of the income computed on a cash

basis or the income computed on an accrual basis. Depending on the nature of the particular professional practice, the transitional provisions could result in an undue financial strain being imposed where the opening untaxed inventory of work in process and accounts receivable is brought to tax within the first few years of introduction of the new system. The untaxed opening balance will remain untaxed throughout the profession's business life in any case where the practice shows a steady growth and its inventory of unbilled work in process and its accounts receivable increase steadily year by year. Where, however, the business fluctuates from year to year, it is likely that the opening untaxed balance will be brought into income fairly rapidly because in a year of expansion, the unbilled work and accounts receivable will grow but will be reduced in a subsequent year when the business contracts somewhat. This reduction will result in the opening balance being taxed to the extent of the reduction and over a relatively short period could result in the entire amount being brought into income.

We recommend that the Proposal to compute the income of taxpayers in the professions on an accrual basis be discarded as inappropriate.

If our proposal in the preceding paragraph is not accepted, we recommend that the transitional provisions be modified so that the opening untaxed balance of work in process and accounts receivable remain untaxed until such time as the aggregate of accounts receivable and work in process is reduced below the opening balance and any remaining amount only be brought into income at the time when work in process and accounts receivable are eliminated, sold, or bequeathed on death.

Investment Income of Clubs and Other Non-Profit Organizations:

The White Paper proposes to tax the investment income of social clubs and other non-profit organizations. While we suspect that there is little revenue to be derived from this proposed change and think that it is relatively unimportant, we have no real objection to it insofar as it applies to social clubs and similar recreational organizations.

However, the Proposal links taxation of investment income to exemption from income tax under the provisions of Section 62(1)(i) of the Income Tax Act. This section includes many organizations whose functions are quite different from those discussed in the preceding paragraph. Organizations exempt under Section 62(1)(i) include many that devote their funds to the improvement of their profession, to providing scholarships and to other activities in the public interest.

If Section 62(1)(i) is used as the criterion for imposing tax on the investment income of non-profit organizations, various professional associations such as the Canadian Bar Association, the Canadian Institute of Chartered Accountants and many others would be taxed on their investment income. These organizations retain funds to

provide for special projects, research, education, etc. Also taxable would be alumni associations which through bazaars and similar activities accumulate funds to provide scholarships. The perpetual care funds of cemeteries will also be subject to tax on income from investments retained to meet obligations imposed on them by law or contract.

We note that a number of organizations such as Boards of Trade, labour unions, etc. are exempted from tax by other sections of the Income Tax Act and it is our view that the use of Section 62(1)(i) to determine the application of this proposed change is quite inappropriate.

We recommend that the scope of the Proposal be narrowed by establishing a separate exempting clause for organizations whose prime purpose is social or recreational and whose earnings, if any, are used for the pleasure and enjoyment of members and to provide for tax on the investment income of this type of organization only. To avoid administrative inconvenience, tax should only be payable where investment income exceeds (say) \$1,000. annually.

Trusts:

The Government has distinguished in its Proposals between those trusts which are similar to widely-held public corporations and mutual funds and those which hold property for the benefit of specific beneficiaries and are commonly described as inter vivos or testamentary trusts. We believe trusts that operate businesses ought to be treated for tax purposes as though they were corporations and those that are similar to mutual funds should be treated in the same way as we have recommended in Chapter D for mutual funds.

In the case of inter vivos or testamentary trusts, however, we believe that the Government's Proposals while somewhat indefinite, are likely to be unfair. The Proposal is deceptively simple since it proposes that a tax of approximately 50% would be applied to all income received and retained by such a trust.* There is no suggestion that when the funds are ultimately paid out to a beneficiary, the rate of tax would be adjusted in the light of the beneficiary's tax status.

We believe that this Proposal is unfair because it would be retroactive in its application. There is a large number of trusts in existence today which provide for or require the accumulation of income for stated periods of time. For example, it is not uncommon for a testator to provide that during the infancy of the beneficiaries of his estate the income of the estate to the extent necessary is to be applied to the maintenance of the beneficiaries and that income in excess of their requirements is to be accumulated and added to the capital of the estate. It seems unduly harsh to subject such accumulations to a tax rate in excess of 50%, particularly where it may not be possible to change the terms of the trust.

We recommend that:

- (a) the rate of tax payable by the trust should be determined by reference to the circumstances of the beneficiary or

* This rate would correspond closely to the corporate rate and the top rate of personal tax suggested for the fully matured system.

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- that credit be given for taxes paid when the income is distributed and a refund granted if the circumstances of the beneficiary so warrant, and
- (b) the present method of taxing trusts be continued with respect to existing trusts.

TAXATION OF INTERNATIONAL INCOMEIntroduction:

The White Paper proposes some far-reaching revisions in the taxation of income flows to and from Canada and we believe that there is considerable merit in some of them. We are, however, concerned that certain of the Proposals would hamper the foreign business activities of Canadian companies, discourage valuable non-resident investment in Canada, and prevent the free exchange of personnel and information between Canada and other countries.

The White Paper proposes significantly less favourable tax treatment for the taxation of international income flows (both income originating abroad and received in Canada, and income originating in Canada and paid to non-residents), in cases where the foreign country involved has not signed a tax treaty with Canada.

We fully appreciate, and to a degree support, the Government's desire to initiate some distinction between income flows involving countries with which Canada has a tax treaty, and those which do not. Such a distinction is found in the tax systems of many other countries and the introduction of such a distinction in our tax system would strengthen our position in securing tax concessions from other countries. However, we think that the White Paper has over-emphasized the advantages to Canada of obtaining international tax treaties, and has tended to place too great a disadvantage, at least in some circumstances, on income flows to and from countries with which we do not have a treaty.

We believe that the Government may have substantially underestimated the difficulties of obtaining tax treaties with other countries. There are 122 countries presently recognized as members of the United Nations, plus a substantial additional number of countries which are not members of that body. At the moment, Canada has tax treaties with only fifteen countries, most of them in Western Europe. We believe that Canada will experience substantial problems and delays in extending its network of tax treaties, not only because of the length of time required to negotiate complex commercial arrangements with a large number of governments, but also because certain important aspects of the proposed taxation system will prove unpalatable or even unacceptable to some countries.

In this connection, the following specific observations can be made:

- (a) the Proposal to tax non-residents on their capital gains on Canadian securities in a number of circumstances is at variance with most international tax treaties and with general international practice. It will undoubtedly create difficulties in some treaty negotiations. The suggestion that non-residents owning control blocks of shares in widely-held Canadian companies re-value such securities every five years will also create major problems in reconciling Canada's tax system with those of other countries;
- (b) the Proposal that persons giving up their Canadian residence be taxed on unrealized gains on their assets is again not usual in international tax practice, and may create difficulties in treaty

negotiations because other countries will object to this type of provision being applied to their nationals returning from Canada;

- (c) many of the developing countries of Latin America, Africa, and Asia are traditionally reluctant to sign any tax treaties at all: in some cases, there may be a feeling that such treaties represent a vestige of colonialism or could be used to justify some intervention in the domestic economy of the country;*
- (d) we understand that it may be the intention of the Government to seek to obtain, in all treaties that it negotiates, provisions for tax and even tariff advantages for Canadian residents operating in the foreign jurisdiction, together with provisions for exchange of information, etc. These intentions will again lengthen and complicate treaty negotiations.

Because of these difficulties, we believe that there are serious practical limitations on the White Paper's intention to rely upon bilateral tax treaties as the cornerstone of Canadian tax policy in the international area and we suggest a more flexible policy in this area.

CANADIAN TAXATION OF FOREIGN INCOME

Foreign Direct Investment by Canadian Companies:

The White Paper proposes that dividends received by Canadian companies from foreign direct investments in countries with which Canada has a tax treaty should continue to be exempt from Canadian corporate tax but that dividends received by Canadian companies from direct investment in other countries should be subject to corporate tax, with appropriate credit being given for underlying foreign corporation and withholding taxes.

The taxation of dividends received from such "controlled foreign corporations" in non-treaty countries will create serious problems for Canadian companies with existing investments in such areas, investments which were committed at a time when their dividends could be received free of tax by the Canadian parent. The Proposal will impose a substantial additional burden on the foreign business operations of many Canadian companies without yielding any significant offsetting advantages to Canada. In particular, the ability of Canadian companies to expand abroad and develop multi-national operations will be reduced.

We are particularly concerned about the impact of the suggested change on existing and future Canadian investment in developing countries. An unintended result of the Proposal might be to divert Canadian investment from developing countries, which are reluctant to enter into tax treaties, to mature industrialized countries where tax treaty arrangements already exist or can be more readily negotiated.

The White Paper Proposals only partially recognize the substantial advantages which Canada derives from activities carried on by foreign subsidiaries of Canadian companies. Such direct investments frequently serve to stimulate Canadian exports, and to provide both markets for Canadian pro-

* The United States of America, with substantial investments in many foreign countries has at the moment only one operative tax treaty with a developing country.

duced goods and sources of raw material for Canadian manufacturing activities. Furthermore, if Canadian corporations are induced, because of tax considerations, to refrain from investing abroad and expanding their activities in the international sphere, they will be put at a substantial long-run disadvantage in competing with foreign corporations whether abroad or in Canada.

The Proposal that raises the general rate of withholding tax to 25% on property income payments to residents of countries with which Canada does not have a tax treaty is obviously intended to provide some leverage for negotiating favourable tax treatment for Canadians with income originating in those countries. We presume that the proposal to treat dividends from subsidiaries in non-treaty countries in a less favourable manner than dividends from subsidiaries in treaty countries is also motivated by a desire to conclude favourable tax treaties. However, we doubt its efficacy as an inducement to other countries to offer tax incentives to Canada. Canadian investment abroad is frequently not of critical importance to the recipient country, and in any event we believe that many governments will be reluctant to enter into tax treaties with Canada merely to obtain more favourable treatment for their own investors under Canadian tax laws.

We cannot agree with the concept that Canada should impose sufficient Canadian tax on dividends received by Canadian corporations from direct investment in a non-treaty country to bring the aggregate income taxes imposed on such income up to the Canadian corporate rate of tax. Many foreign countries have radically different tax systems than Canada, with different degrees of reliance on income taxes and other forms of taxation. Canadian-owned corporations operating abroad are competing with other foreign companies that in many cases are allowed to retain the advantages offered by lower corporate income tax rates in some jurisdictions. As the White Paper itself indicates, the validity of the concept that Canada should always attempt to bring the total income tax burden on such income up to Canadian levels is not clear.

Any effort to impose significant taxes on the repatriation of the foreign earnings of Canadian corporations will undoubtedly lead to such income being kept offshore indefinitely. It is not in Canada's interest to have a tax system which prevents the repatriation of foreign profits to Canada.

Without more information than is now available it is not possible for us to evaluate the impact of the proposed "gross up and credit" treatment proposed for the taxation of dividends from direct investments in non-treaty countries. However, we anticipate that the proposed method whereby the Canadian Government would tax this foreign source income may well be significantly more onerous than that employed by the United States and by a number of other important investing nations.

We recommend that the present exemption (provided under Section 28(1)(d) of the Income Tax Act) be retained for all dividends received by Canadian corporations from foreign corporations in which the Canadian company owns at least 25% of the voting stock.

In the event that the Government rejects our recommendation

that all dividends from foreign affiliates should continue to be exempt from Canadian tax at the corporate level, we recommend that as a substantially less acceptable alternative, the White Paper's Proposals concerning the taxation of direct foreign investment income be modified as follows:

- (a) the present exemption from Canadian corporation income tax should be retained for dividends received by Canadian corporations from controlled foreign corporations located in a developing country. Furthermore, any tax imposed by Canada on dividends received by Canadian companies from foreign affiliates in developing countries (and perhaps elsewhere) should give due recognition to all foreign tax incentives provided to the foreign subsidiary, so as to ensure that Canada would not tax away the legitimate incentives provided by foreign governments;
- (b) in computing the ratio of foreign tax to the income of the foreign subsidiary for gross-up and foreign tax credit calculation purposes, the income of the subsidiary should be determined to the greatest extent practicable by reference to foreign tax and accounting provisions. No adjustment should be made in Canadian foreign tax credit calculations for items which represent only differences of timing;
- (c) the foreign tax credit claimable by Canadian taxpayers should be modified so that it applies on an overall basis with respect to all foreign income and taxes rather than on a country-by-country basis as at present;*
- (d) excess foreign tax credits should be allowed to be carried back a minimum of one year and forward a maximum of five years;
- (e) subsidiaries of foreign subsidiaries of Canadian companies should be treated in a like manner for foreign tax credit and other purposes as the foreign subsidiaries themselves. Despite the complexities involved, we suggest that such legislation should extend at least to third-tier foreign subsidiaries;
- (f) where the foreign affiliate is located in a jurisdiction which imposes an income tax at a rate of at least (say) 35%, the Canadian parent of such subsidiary should have the right to elect that any taxable dividends received from the subsidiary shall be treated as exempt from Canadian corporation tax provided that the total of such dividends received does not exceed on a cumulative basis the total amount of foreign income taxes actually paid to the foreign jurisdiction by the subsidiary.**

* The overall foreign tax credit is presently available under US tax laws.

** This procedure would avoid complex gross-up and credit calculations with respect to dividends which in any event are likely to be subject to little Canadian tax.

Passive Income:

The White Paper proposes that the so-called "passive" income (such as interest, royalties and inter-company fees) of controlled foreign corporations of Canadian companies be subject to immediate taxation in the hands of its Canadian parent, with credit allowed for any foreign taxes paid on such income. These provisions are to be modelled, at least in part, along the lines of "Sub-part F" of the United States Internal Revenue Code,* but as no details of the Proposal are available we are restricted in our ability to comment on this area. However, we are in favour of reasonable provisions whereby the revenue authorities can circumvent off-shore tax avoidance schemes. We are, therefore, prepared to accept the introduction of some rules for the immediate taxation in Canada of certain passive income of the foreign subsidiaries of Canadian companies or for that matter foreign corporations controlled by Canadian individuals.

We think it extremely desirable that whatever provisions are adopted should be so framed that they result in a minimum of reporting and enforcement complexities to taxpayers and revenue authorities alike. The main concern of the Government should be to prevent significant leakages in Canada's tax revenues and to eliminate situations where Canadian residents escape their fair burden of Canadian tax through artificial transactions carried out abroad. In this respect, we believe that the Canadian taxation authorities have not adequately used the present provisions of the Income Tax Act to counter some practices which have developed under the present system.

Frequently, Canadian corporations operating abroad utilize foreign subsidiaries to achieve reductions in the foreign income taxes otherwise payable by other foreign operating subsidiaries. For example, it may be highly desirable from a commercial view point to enter into arrangements that will result in one foreign subsidiary of a Canadian company paying interest, rents, royalties or other inter-company charges to a second foreign subsidiary. Such payments are frequently necessary to avoid foreign exchange difficulties, to reduce business risks, and to minimize the foreign income taxes payable on foreign business activities. If Canadian companies were denied the right to use such means of reducing their foreign business risks and tax liabilities, they would be placed at a serious disadvantage relative to the subsidiaries of companies incorporated in other foreign jurisdictions. We believe that all profits originating from bona fide foreign business operations of subsidiaries of Canadian companies should be excluded from any passive income provisions, regardless of where abroad or in what form such profits have been received.

We recommend that in drawing up provisions for the taxation of passive income:

- (a) income originating and taxed in jurisdictions with relatively high rates of tax should be exempt from the passive income definition. The same exemption should apply to the unrepatriated portion of foreign passive income where a substantial portion of it is currently brought back to Canada as taxable income;
- (b) the designation of passive income should not extend to any

* The types of income that can be subject to immediate taxation under "Sub-part F" include interest, rents and royalties; certain trading profits arising out of selling goods to affiliated companies; and some management charges.

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income directly related to a bona fide active business carried on by foreign subsidiaries;

- (c) investment and other passive income earned by a controlled foreign corporation should not be subject to a passive income designation if it did not exceed a stated percentage (say) 20% of the total income of the foreign subsidiary; *
- (d) dividends, interest, rents, royalties and management fees derived by one foreign subsidiary of a Canadian company from another foreign subsidiary should be excluded from the passive income rules where the second foreign subsidiary carries on a bona fide active business and the payments in question are made in connection with that business. The same exemption should also apply to inter-company trading profits and other similar gains, made by one foreign subsidiary in dealing with another foreign subsidiary, but only when such income relates to bona fide business operations carried on outside Canada.

We further suggest that all Canadian taxpayers who own (either alone or in conjunction with affiliates) a 25% or greater interest (directly or indirectly) in any foreign corporation be required to disclose on their Canadian tax return specified information concerning the foreign corporation and its operation. Failure to disclose the required information (which would include an abbreviated summary of transactions between the foreign affiliates and the Canadian company) could result in loss of exemptions and/or foreign tax credits otherwise available with respect to income derived from the foreign affiliate.

Export Incentives:

Under international trade rules, Canada is discouraged from providing any direct rebate to exporters with respect to the Canadian corporation income taxes paid on profits relating to the export sales. However, these rules do not prevent exports being exempted from all sales and similar taxes in their country of origin. Because of this feature, Canada is at a relative disadvantage in export markets to other countries which raise a higher percentage of their total tax revenues in sales taxes than this country, and which do provide exemption from such taxes for exported goods.

A number of Canadian exporters have utilized the services of foreign corporations as a means of facilitating their exports of Canadian produced goods. In some cases, these arrangements have resulted in an overall reduction in taxes on export profits, thereby providing the exporters with a better opportunity to penetrate foreign markets in which they might not be able to compete if full taxes were exigible on their profits. The profits earned in the foreign subsidiary may not represent profits diverted from Canada, because there are provisions in the Income Tax Act to prevent the Canadian manufacturer from selling to the foreign subsidiary at less than fair market value. Rather, the profits realized by the subsidiary may be that portion of the total profit obtained from the sale of merchandise

* Under US tax laws, such investment income of controlled foreign subsidiaries is not subject to tax under "Sub-part F" rules unless it exceeds 30% of the foreign subsidiary's income, and for the purpose of this calculation a number of foreign subsidiaries can be considered as one.

that was attributable to the merchandising and other activities carried on by the subsidiary outside of Canada.

It seems likely that the White Paper Proposals as presently outlined would prevent the continuance of these procedures, because export profits realized by the foreign subsidiaries would be classified as "passive" income and thereby subject to immediate Canadian taxation.

We believe that taxing Canadian exporters on that portion of the profits on the export of Canadian goods that is properly attributable to activities carried on by a foreign subsidiary in a foreign (and low tax) jurisdiction would impair their competitive position. The proposal would not only weaken their competitive position vis-a-vis exporters from countries that lean more heavily on sales taxes for their revenues but also as against exporters from countries that do not tax unrepatriated foreign subsidiary profits of this nature. The United States already has provisions offering tax incentives to exporters in its "Western Hemisphere Trade Corporation" provisions and some expansion of these incentives is currently receiving serious study by the US Treasury.*

We recommend that the Government consider excluding bona fide merchandising profits realized by foreign subsidiaries of Canadian companies from the definition of "passive income".

Provisions affecting International Personnel Transfers:

There are a number of cases where executives, technical experts, and other specialists from abroad come to Canada for a limited period of time to provide special assistance to Canadian organizations, and where Canadian-based employees are temporarily transferred abroad to assist in the foreign operations of Canadian companies or to gain valuable experience. This international rotation of personnel enables Canadian organizations to obtain access to skills and services which might otherwise be unavailable at relatively modest cost, and to deploy their entire personnel resources effectively amongst the countries in which they operate.** The international exchange of information and skills which takes place as a result of these transfers enables both specific Canadian corporations and the general Canadian business community to obtain information and talents that might not otherwise be available to it, and enables Canadian companies to operate efficiently abroad.

The proposal that all persons leaving Canada be required to pay Canadian tax on accrued but unrealized gains on all of their assets would be a serious and highly undesirable impediment to the free transfer of personnel between jurisdictions. While we do not quarrel with the theoretical merits of such a tax as part of a system for allocating gains and taxable revenues between various countries, the practical effects of this proposal would be to place a substantial barrier on the transfer of skilled personnel between Canada and other countries.

We believe that most of the individuals who would be subject to

* The US Treasury Department has proposed an indefinite deferral of the US taxes otherwise payable on export profits by Domestic Incentive Sales Companies (DISC).

** In many cases, such personnel when transferred to Canada for temporary periods decide to remain in this country indefinitely and to become citizens of Canada, thus expanding our ranks of skilled personnel without Canada having to absorb the considerable expense of training them.

this tax could obtain little credit or other recognition for the tax in the country to which they were bound, and might even subsequently be required to pay tax again in a foreign jurisdiction on the gain which had already been taxed on an accrual basis by Canada. In particular, the Canadian tax on gains accrued on items such as personal property, household effects, personal residence, etc., would be imposed in circumstances where there was no real possibility of obtaining any relief or offset for it in other jurisdictions.

Such a system of taxation, when combined with the relatively high rates of Canadian personal taxation, would provide a severe discouragement to obtaining the services of foreign professors, technical experts, and executives in Canada, and to the temporary transfer abroad of similar Canadian personnel. It is obvious that such an inhibition against international personnel transfers would work only to the detriment of Canada. We note that in many cases, a tax imposed on the accrued gains of persons leaving Canada would be, in essence, a tax on honesty. There is no practical means whereby Canada could enforce the collection of such a tax against people who are determined to avoid it, and who transferred their Canadian assets into liquid form which they would take with them on their departure from Canada.*

We suggest that the proposed "departure tax" be modified as follows:

- (a) in the case of Canadian citizens and their dependents leaving Canada for a temporary stay abroad, they be given the option of being exempted from tax on accrued gains on departure, provided they undertake to file Canadian tax returns during the period when they are not resident in Canada, reporting their capital gains (as realized) and investment income, and paying Canadian tax thereon, with due allowance for foreign taxes. The income of such persons earned outside Canada should not be subject to Canadian tax because that income is earned in competition with other persons abroad;
- (b) in the case of citizens of other countries coming to Canada for temporary periods of up to (say) ten years, they should be subject to Canadian tax on capital gains and other income actually realized while in Canada** and should not be subject to any tax on deemed realizations when leaving Canada;
- (c) all persons subject to any form of taxation on accrued capital profits when leaving Canada should be afforded some initial exemption from accrued gains taxation of (say) \$10,000. and in addition, all unrealized gains on personal property held for their own use should be exempt;
- (d) individuals subject to Canadian tax on accrued gains on their departure from Canada and who are subsequently taxed again, in a different country, on substantially the same gain should be permitted to re-file their final Canadian tax return and claim a credit against Canadian taxes for such foreign taxes;

* Virtually all countries refuse to allow other countries to enforce tax claims against domestic residents.

** In determining the amount of realized gain to be taxed in Canada, the profit might initially be calculated by reference to original cost, and then only that portion of the gain related to time spent in Canada might be taxed.

- (e) the Government should be prepared to modify the proposed tax in tax treaties with other countries.

Limitation of Foreign Tax Credit:

It is proposed that Canada should limit the amount of foreign tax credit claimable in respect of foreign portfolio investments by Canadian residents to a maximum of 15%. We consider that this limitation has no justification, particularly as Canada itself proposed to impose higher withholding tax rates than 15%. In the case of persons immigrating to Canada or receiving bequests from abroad, it is frequently difficult or impossible because of foreign exchange control and other restrictions to rearrange foreign investments so that the maximum foreign withholding tax would not exceed 15%. The Proposal would have the effect of imposing a substantial additional tax burden on a class of taxpayer who may be unable, through no fault of their own, to re-arrange their affairs.

The Proposal would also have a particularly unfortunate effect on the number of United States executives and technical experts who are resident in Canada. Because of the special provisions in the United States Internal Revenue Code, US citizens residing in Canada are frequently required to pay US taxes in excess of 15% on investment income derived from US sources. Furthermore, many of them find it advisable to retain their investments in US securities because the US "interest equalization" tax makes it uneconomical for them to purchase other investments. If Canada limited the foreign tax credit that such persons could claim on their foreign investment income to a maximum of 15% they would be put in a disadvantageous position. Here again, the effect of the Proposal would be to hamper the free exchange of personnel between Canada and other countries.

We recommend the rejection of the proposed limitation of the foreign tax credit on portfolio income to a maximum of 15%.

"Flowthrough" of Foreign Withholding Taxes:

We have reviewed the White Paper Proposal relating to the "flowthrough"* of foreign taxes borne by Canadian companies. Despite certain technical problems which we foresee in its implementation we think that this Proposal offers a partial offset to the disadvantages that shareholders of Canadian corporations with important foreign operations would otherwise suffer under the White Paper Proposals, and we are in general agreement with the suggestions put forward in this area.

CANADIAN TAXATION OF NON-RESIDENTS

The White Paper contains a number of proposals that in some instances increase the Canadian taxation of the income of non-residents of Canada. Furthermore, the White Paper also provides substantial incentives for Canadians to invest in Canadian corporations, incentives which would not be open to non-residents of Canada. While some concern

* The "flowthrough" proposal would allow 15 percentage points of foreign tax to pass through the Canadian corporation and to qualify for credit treatment in the hands of the final shareholder.

has been expressed from time to time as to the extent of the non-resident investment and control of the Canadian economy, there is no doubt that Canada has benefited substantially from inflows of foreign capital. We have some concern that the changes suggested in the White Paper might, in the aggregate, tend to discourage the inflow of foreign capital and other resources into this country and might therefore have an adverse effect on the growth of the Canadian economy.

General Increase in Withholding Tax Rates:

The White Paper proposes that the general rate of Canadian withholding tax be increased from 15% to 25%. However, the Government has indicated its willingness to accept a lower rate of withholding tax (generally 15%) in the case of payments of dividends, interest, rents, royalties, etc. made to residents of a country with which Canada has a tax treaty. Presumably, Canada expects to obtain corresponding concessions from foreign jurisdictions with respect to the imposition of their withholding taxes on income flows from that country to Canada. While we do not oppose the principle of this general increase in non-resident withholding tax, we are concerned with certain effects of its implementation.

At the present time, there appears to be a world-wide shortage of investment funds. Substantial capital is, however, available from countries that could be classified as "tax havens", and a number of important Canadian corporations and even governments have borrowed funds from sources within such jurisdictions. The net effect of the proposed increase in withholding tax rates will be to restrict Canadian access to funds which might otherwise be borrowed from within these jurisdictions.

We suggest that the Government review very carefully the possible consequences of the increase in the rate of withholding tax on interest paid on arm's-length borrowings from non-treaty countries to ensure that it will not have an adverse effect on the total available supply of loan capital to Canadian enterprises.

Retroactive Change in Rates of Withholding Tax on Existing Bonds:

We have some reservations about the transitional rules suggested by the Government in relation to the implementation of the proposed higher withholding tax rates.* These transitional rules contemplate that the withholding tax rate on many types of presently existing obligations would be increased in 1974. While such an increase may be acceptable in the case of dividends, royalties and rents, we are concerned with the effect of an increase in tax on interest on existing bonds. Recent increases in the withholding tax rates on debt securities issued in

* The White Paper proposes the increased withholding rates, except where overridden by treaty provisions, would go into effect with respect to payments of interest, rents, royalties, etc. on 1 January 1971, except where such payments were made in accordance with agreements entered into before 7 November 1969 in which case the rate of tax would remain at 15% on interest on debt held in arm's-length situations, if the obligation arose before 1974 and the creditor is resident in a country with which Canada presently has a tax treaty limiting the withholding tax to 15%.

arm's-length situations have not applied to interest on existing debts, and we note that the Government does not intend to apply the increased tax to presently exempt interest on existing federal, provincial and municipal bonds.

We recommend that the proposed increases in the rate of withholding tax should not apply to interest on fixed term debt originated prior to 7 November 1969.

Non-Resident Owned Investment Corporations:

The White Paper proposes that the rate of tax exigible on the income of non-resident-owned investment corporations be increased from 15% to 25%. We also understand that capital gains realized by such corporations would be included in their taxable income for Canadian tax purposes. These changes will mean the virtual elimination of non-resident-owned investment companies because the tax imposed on them in these circumstances would be substantially more than the tax that would be imposed on non-resident investors who purchased Canadian securities directly or through a tax haven company.

We can see no reason why the Canadian Government should seek to eliminate the usefulness of such companies, which create employment for Canadian personnel and advisors and provide a convenient mechanism for non-resident investors to purchase portfolio investments in Canadian corporations.

We recommend that the White Paper Proposals should be modified as follows:

- (a) a non-resident-owned investment corporation which can show that shareholders having an economic interest in the corporation of at least 90% were resident in a jurisdiction which had a tax treaty with Canada providing for a general rate of withholding tax on dividends and interest no higher than 15% be taxed at 15% instead of the proposed rate of 25%. A further qualification might be that the company earn no more than stipulated percentage of its income from interest on non-arm's-length loans;
- (b) capital gains realized by a non-resident-owned investment company on the sale of securities be exempt from Canadian tax to the same extent that they would have been had the securities in question been sold by a non-resident of Canada.

Capital Gains Tax on Non-Residents:

The White Paper proposes that non-residents of Canada should be liable to Canadian income tax on capital gains realized by them on the sale or exchange of certain Canadian assets. Specifically, the White Paper recommends that non-residents should be liable to Canadian taxation on capital gains realized on the sale of Canadian real estate, the assets of Canadian branches of foreign companies, shares of closely-held Canadian companies, and sales out of a control block (25% or more) of shares of a widely-held Canadian company.

We agree with the extension of Canadian capital gains taxation to gains realized by non-residents on the sale of Canadian real estate or on branch assets. However, we believe that the Proposal in the White Paper to tax non-residents on gains from certain sales of Canadian corporation shares is an unwise and unnecessary move. We think it will create serious difficulties for Canada in international tax treaty negotiations and will have a number of other undesirable effects including discouraging desirable foreign investment in Canada.

Any attempt by Canada to impose a tax on capital gains realized by non-residents on the sale of shares of Canadian companies would be contrary to general international tax usage, which normally reserves the right to tax such gains to the jurisdiction in which the vendor resides. The United States, the United Kingdom, and a number of other important foreign countries are generally opposed in any international tax treaties which they negotiate to the concept that the jurisdiction in which a corporation is located should have the right to tax capital gains accruing on the sale of the shares of that company. Because of this, any insistence by Canada on its right to tax such gains may well jeopardize the successful negotiation of tax treaties with a number of important foreign jurisdictions. In addition, taxation of such gains by Canada is at variance with the provisions of the draft OECD International Tax Treaty which the White Paper acknowledges as representing the norm among the major developed countries.

Any attempt to impose such a tax on non-resident share gains will result in substantial administrative difficulties and complexities, and will require provisions which the White Paper itself recognizes as "awkward". The Report of the Royal Commission on Taxation recommended that gains derived by non-residents from the sale of Canadian securities should not be subject to tax in Canada because of the administrative and compliance problems involved.

We also note that, at least in the case of gains on the sale of closely-held corporations, the Canadian tax rates applicable to such profits would be in excess of those which would prevail elsewhere, limiting the ability of the non-resident to obtain credit for the Canadian tax against taxes which may be imposed in his own jurisdiction. In addition, the justification for imposing relatively high rates of Canadian capital gains tax on non-residents who would never benefit from the White Paper's "integration" Proposals is not clear to us.

If the Government's Proposals are adopted, foreign investors owning the controlling shares of Canadian companies would be free to transfer such shares to a company incorporated in that foreign jurisdiction: the foreign investor will then be able to sell the shares of this foreign parent company without incurring any liability for tax in Canada.

However, because Canadians would not normally wish to acquire the foreign parent, this means of avoiding Canadian taxation will not generally be available to a non-resident selling to a Canadian purchaser. Accordingly, the imposition of Canadian tax on such capital gains will mean that non-residents now owning control blocks of shares of Canadian corporations could suffer a substantial tax penalty if they sold the shares to Canadians. In effect, a Canadian purchaser of such shares will be put

at a relative disadvantage as opposed to another non-resident person wishing to acquire them because the Canadian will not only have to meet the price offered by the other non-resident but, in addition, will have to compensate the non-resident vendor for the Canadian tax that he will have to pay if he sells the shares of the Canadian corporation rather than the shares of the foreign parent company. This means that further difficulties will be placed in the way of Canadians wishing to re-purchase control blocks of Canadian shares from non-residents--a consequence that we believe to be highly undesirable.

We recognize the problem discussed in paragraph 6.45 of the White Paper that if no capital gains taxation is imposed upon the vendors of shares of closely-held Canadian companies, some possible loophole in our tax laws may develop because Canadian purchasers of such companies may be able to take advantage of "creditable tax" accrued while the company was owned by non-residents. We think that there are other and more satisfactory means of avoiding this difficulty than subjecting non-residents to capital gains taxation in Canada. One means of attaining the desirable result would be to provide for cancellation to a purchaser of the tax benefits he might obtain from the "creditable tax" on hand in a Canadian corporation where a control block of shares passed from a non-resident to a resident of Canada. (This cancellation of benefits would also apply to the tax exigible on unrealized gains relating to the corporation's assets at the time of the sale of its shares.)

We recommend that no tax be imposed by Canada on capital gains realized by non-residents on the sale of shares of Canadian companies.

Thin Capitalization:

The White Paper proposes to restrict the deductibility of interest paid by non-resident-owned Canadian corporations which the Government regards as "thinly capitalized"--i.e., which have insufficient paid up share capital and surplus in relation to loans from shareholders and related parties. We appreciate the reasons for this Proposal; but experience in other countries suggests that it is unlikely to be effective because of the ease with which the restrictions may be avoided by the use of "back-to-back" loans.

We suggest that the Government reconsider the advisability of introducing a "thin capitalization " provision into our tax statutes.

APPENDIX "C"

*Submission by the
Vancouver Board of Trade
with respect to proposals contained
in the Government of Canada's
White Paper on Taxation*

April, 1970

This brief is submitted by the Vancouver Board of Trade in response to the request of the Minister of Finance for comment on the White Paper "Proposals for Tax Reform".

The 3,200 members of the Vancouver Board of Trade represent a broad and significant cross-section of every facet of industrial, commercial, and professional activity in the Province of British Columbia.

Parts B and C of the brief were drafted under the direction of the Chairman of the Taxation Committee of the Vancouver Board of Trade following the completion of analyses and studies carried out by members of that committee.

Part A of the brief was prepared, on behalf of the Board, by Professor A.R. Ilersic, the noted economist and international authority on taxation. Professor Ilersic is Professor of Social Studies in the University of London. Since 1951, Professor Ilersic has been the United Kingdom correspondent to the Canadian Tax Foundation. He is the author of two standard works on taxation and fiscal policy: Government Finance and Fiscal Policy in Post-war Britain, and Taxation of Capital Gains. Professor Ilersic is a regular contributor to professional accounting and industrial journals on economic and tax issues and has been advisor to government departments and industrial bodies. He was responsible for the new rate equalisation scheme introduced in Greater London in 1969.

BRIEF SUBMITTED BY THE VANCOUVER BOARD OF TRADE
WITH RESPECT TO THE WHITE PAPER
PROPOSALS FOR TAX REFORM

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INTRODUCTION AND SUMMARY OF CONCLUSIONS

The prolonged period during which tax reform has been studied and discussed in Canada is beginning to create an atmosphere in which comment or criticism which suggests that further deliberations may be necessary is made only at the risk of being accused of a negative attitude.

It is with reluctance, therefore, that the Vancouver Board of Trade suggests that further deliberations are indeed necessary, but such is the conclusion reached by the Board after many weeks of intense and careful study of the White Paper proposals and of the economic backdrop against which the proposals are set.

The White Paper proposals echo many of the sentiments and adopt a significant number of ideas of the Carter Report on Taxation. In addition, the government's assessment of the economic effects of the White Paper proposals appears to lean heavily on that Royal Commission Report. The Board considers that, as a result, the government's approach has been overtaken by events.

Specifically,

1. The serious abuse to which the present income tax structure

was being subjected in September 1962 when the Carter Commission was established has by now been largely removed as a result of vigorous assessing policies initiated by the Department of National Revenue. The impulse toward tax reform stemming from a need to stop wholesale abuse is, therefore, largely removed.

2. The terms of reference of the Carter Commission excluded studies of government expenditures. Even the Commission itself indicated the dangers of concentrating its studies on - as the Commission put it - "only one blade of a pair of scissors". Since 1962, the pace of spending by governments at all levels has increased at a rate far greater than was then anticipated. The percentage of Gross National Product represented by public sector spending is now at a level which commands more concerned attention than was the case in 1962 and even in 1967 when the Report was issued.

Of equal concern is the fact that the entire relationship between Federal and Regional government spending has changed dramatically over the past seven years. So much so, that the Board is at loss to know how sweeping tax changes can be safely implemented without the most intensive co-ordination between the Federal and Regional governments.

This Board believes, therefore, that no further changes in the existing tax structure should be made unless they are shown to be necessary after the following statements on governmental policy have been issued.

- (i) An explanation in depth of the government's policy and ideas as to the extent of Canadian public sector spending during the next quinquennium. In particular, the public should be given an opportunity to review the government's thinking as to future policies concerning :
 - (a) Education
 - (b) Public housing
 - (c) Medicare
 - (d) Family Allowances
 - (e) Pensions
 - (f) Government investment.
- (ii) The federal government should then indicate how it envisages financing these programmes both in terms of direct and indirect taxation.
- (iii) The federal government must reach agreement with the Regional governments with a view to setting before the public an estimate of the total tax impact on all levels of taxpayers which anticipated government spending at all levels would - under current thinking - produce. The division of such total tax cost between the different levels of government should

also be demonstrated.

Although such an approach may not be politically popular in the traditional sense, the Board seriously believes that the pace and priorities of future government spending must be explained to the public and that the dissension between different levels of governments must, somehow, be solved. Otherwise we shall run the danger of so burdening and bemusing Canadian taxpayers that their productive energies and initiatives will be dissipated.

With respect to the White Paper proposals per se the Board has reached the following conclusions :

1. The White Paper gives an incomplete and inadequate assessment of the impact of the proposed changes in tax structure and of the extent to which the proposed measures will meet future revenue needs; (see Part A, No. 1 of this brief).
2. Although drawing heavily on the Carter Report's economic assessments, the White Paper does not attempt to meet the various criticisms which were made in respect thereof; (see Part A, No. 2 of this brief).
3. The White Paper appears to have been issued prematurely since -
 - (i) It deals only with direct taxation,

(ii) The reader is left in some doubt as to the government's views on capital cost allowances - a matter of fundamental importance,

(iii) Some of the recommendations in the international area are incomplete,

(iv) Other proposals - such as that relating to the tax on transitional spread (see White Paper paragraph 4.79) represent ideas which are only embryonic,

(v) Some important proposals do not appear to be supported by empirical studies,

(vi) Administrative matters are not dealt with.

4. A number of specific proposals are not equitable in the layman's sense of the word (even though they may fit within some economic theory) and are, in the Board's view, unsuitable and unacceptable to Canadians generally. These proposals are analysed in depth in fifteen separate studies contained in Part B of this brief.

* * * * *

These additional conclusions reinforce the Board's view that the case for the enactment of the White Paper proposals is unproven. However, in the course of its studies the Board became cognisant of certain difficulties faced by the Department of National Revenue in its programme of curbing tax abuse. The Board considers that swift assistance should be made available to the Department in these areas, and to that end, the Board offers a number of concrete suggestions. These are to be found in Study No. 9 of Part B of this brief and in the first two technical discussion papers contained in Part C of this brief.

INTRODUCTION ET RÉSUMÉ DES CONCLUSIONS

Les longues études et discussions provoquées par les propositions de réforme fiscale ont créé une telle atmosphère que tout commentaire ou critique qui requiert une considération plus mûre prend figure d'attitude négative.

C'est donc à son corps défendant que la Chambre de Commerce (Board of Trade) de Vancouver suggère qu'on réfléchisse davantage. Néanmoins c'est seulement après des semaines d'étude intense et attentive des propositions du Livre blanc et de son arrière-plan économique que la Chambre en est venue à cette conclusion.

La réforme du Livre blanc reflète et développe les sentiments et les idées du rapport Carter sur la Taxation, sans compter que les effets économiques estimés sont, aux yeux du Gouvernement, basés sur le rapport de cette commission. Or c'est notre conviction que cette manière d'envisager les choses a été dépassé par les événements.

Pour en venir aux détails:

1. Les abus sérieux auxquels donnait prise la structure fiscale actuelle, en septembre 1962 (lors de l'établissement de la commission Carter), ont été pour la plupart éliminés par la vigoureuse politique du Ministère du Revenu national. Vouloir une réforme pour remédier à des abus d'une telle envergure n'a plus sa raison d'être.

2. Le mandat de la Commission Carter excluait l'étude des dépenses du Gouvernement. La Commission elle-même soulignait le danger de restreindre ses études, selon les propres mots des commissaires, "à une seule lame de la paire de ciseaux". Depuis 1962, les dépenses du Gouvernement, à tous les échelons, ont augmenté à un rythme qui dépasse toutes les prévisions. Elles représentent une telle proportion de la production nationale brute qu'elles requièrent une étude plus serrée qu'en 1962 et même qu'en 1967, date de la parution du rapport.

Un autre fait nous inquiète. Durant les sept dernières années, la proportion d'ensemble des dépenses du Fédéral et de celles des gouvernements régionaux s'est modifiée d'une manière alarmante. C'est à un tel point que la Chambre de Commerce se demande comment on peut songer prudemment à des réformes fiscales sans établir auparavant la plus étroite coordination entre les autorités fédérales et les autorités régionales.

C'est donc la conviction de cette Chambre qu'aucun changement ne devrait être introduit dans la réforme fiscale sans que la nécessité en soit bien établie à la suite de l'exposé de la politique gouvernementale sur les matières suivantes.

i) Une déclaration de politique générale sur l'ampleur des dépenses prévues pour le secteur public dans les cinq années à venir. En particulier, le public doit être édifié sur les idées du Gouvernement par rapport

- a) à l'éducation
- b) aux projets d'habitation publique
- c) à l'assurance-santé
- d) aux allocations familiales
- e) aux pensions
- f) aux dépenses à long terme du Gouvernement.

ii) Le Gouvernement fédéral doit alors déterminer comment il compte financer ces programmes, que ce soit par impôt direct ou impôt indirect.

iii) Le Gouvernement fédéral et les Gouvernements régionaux doivent s'entendre pour mettre devant les yeux des contribuables ce qui les attend comme imposition globale. C'est leur droit de connaître à l'avance le montant des taxes que vont entraîner ces dépenses totales et en particulier leur répartition entre les diverses autorités fiscales.

Selon les données de l'expérience politique, ce ne serait peut-être pas une mesure populaire, mais, aux yeux de la Chambre de Commerce, c'est le devoir du Gouvernement d'éclairer le public sur l'augmentation et les priorités des

futures dépenses. Et, à ce point de vue, il est impérieux que les désaccords entre les divers échelons des autorités fiscales soient résolus de quelque façon. Sans cela, le contribuable canadien sera écrasé et abasourdi à un point qui tuera toute énergie productrice et toute initiative.

Pour en venir concrètement aux propositions du Livre blanc, la Chambre de Commerce en est venue aux conclusions suivantes:

1. Le Livre blanc ne donne qu'une estimation incomplète et inadéquate des effets de la réforme proposée, notamment quant à la mesure où elles vont satisfaire les besoins futurs (voir dans la partie A, No. 1 de ce mémoire).
2. Alors que le Livre blanc se base en grande partie sur les considérations économiques du rapport Carter, il ne se préoccupe nullement de répondre aux critiques qu'on a faites de ce même rapport (voir dans la partie A, No. 2 de ce mémoire).
3. Le Livre blanc semble être apparu prématurément car -
 - i) Il ne touche que l'impôt direct.
 - ii) Il laisse le lecteur entièrement dans le doute sur la politique gouvernementale en matière

de déduction de dépenses capitales, sujet d'importance fondamentale.

iii) Certaines des recommandations en relation avec le domaine international sont incomplètes.

iv) D'autres propositions comme, par exemple, celles relatives à la taxe sur les ajustements transitoires (voir le Livre blanc, paragraphe 4.79), se bornent à des considérations embryonnaires.

v) Certaines propositions importantes ne paraissent pas suffisamment assises sur des études empirique.

vi) Les matières administratives sont laissées de côté.

4. Au simple jugement des profanes, certaines propositions ne sont pas équitables (même si elles concordent avec des théories économiques) et, aux yeux de la Chambre de Commerce, elles ne sont ni appropriées ni acceptables pour l'ensemble des Canadiens. Nous avons examiné à fond ces propositions dans les quinze études distinctes contenues dans la partie B de ce mémoire.

* * * * *

Ces conclusions supplémentaires renforcent la conviction de la Chambre de Commerce que les réformes du Livre blanc ne sont pas justifiées. Toutefois, au cours de ses études, la Chambre de Commerce s'est rendu compte des difficultés que la répression des abus représente pour le Revenu national et estime qu'on doit prêter au Gouvernement une assistance immédiate: c'est là la raison d'être des suggestions concrètes que nous avons soumises. On les trouvera dans l'étude No. 9 de la partie B de ce mémoire et dans les premiers deux rapports de discussions de la partie C de ce mémoire.

PART A

C O N T E N T S

of

Economic studies of the White Paper Proposals prepared
on behalf of the Vancouver Board of Trade by Professor
A.R. Ilersic.

Study No. 1 - Revenue aspects.

Study No. 2 - Economic impact.

Study No. 3 - The taxation of capital gains.

PART A - ECONOMIC STUDIES OF THE WHITE PAPER PROPOSALSNo. 1 - REVENUE ASPECTSa) Introduction

A full evaluation of the economic effects of any proposed tax reform would fill several volumes. For such reasons this section of the present submission is concerned with two specific issues.

1. The first is the fact that the White Paper assessment offers no guide to the future trend of tax revenues and the ultimate distribution of the income tax yield between different income brackets. Since the revenue needs of the Federal government are rising more rapidly than the gross national product, the White Paper should have demonstrated the probable effects on taxpayers at all levels of raising prospective revenue needs on the basis of the proposed tax system.
2. Second, the emphasis in the White Paper on the proposed basis for Federal-Provincial tax sharing diverts attention from a far more significant question. This is, what are the prospective revenue needs of Provincial and Municipal governments and, in meeting them, how will they affect taxpayers? The revenue requirements of the Provinces and Municipalities will grow faster even than those of the Federal Government. Unless there is a firm agreement on tax sharing between the various levels of government, their combined needs could impose very much heavier demands on income taxation than is at present experienced or implied for the future by the White Paper figures.
3. It may be asserted in the face of such criticisms that, given such massive governmental expenditure, the greater degree of equity arising from the White Paper proposals is even more necessary than at present. This is true, but this is hardly the argument used in the White Paper. That demonstrates merely that the main effect of the proposed reform is re-distribution of existing, i.e. 1969 tax levies. The obvious omission is where the rest of the revenue needed in, say, 1974 onwards come from? In part it will come from the higher real incomes of Canadians. But, what is to be the role of indirect taxes? What is to be the fiscal contribution of the lower income groups? If the main part of the additional revenue is to be derived from the higher income groups, then it will be surprising if the

consequences for the economy are as insignificant as the White Paper suggests.

4. In short, it is submitted that the White Paper gives a partial picture only, i.e. by showing the re-distribution of taxation only on the basis of 1969 incomes. When the prospective revenue needs of all levels of government are taken into account, it is the view of the authors of this submission that the White Paper proposals present an altogether misleading aspect. Far from having negligible economic effects, there is every possibility that substantial changes in the tax burdens of economically significant income groups will generate side-effects which would not be to the advantage of the Canadian economy. The reasons for these conclusions are set out in the next two sub-sections of this submission.

b) Federal Revenue Needs

1. The White Paper proposals are "designed to produce approximately the same revenue in the first year of their operation as would the existing system" (para. 9.1). The estimates of the changed distribution of revenue in Tables 15 and 16, even if one takes them at their face value, are of limited utility. They merely show a hypothetical distribution of the tax burden, i.e. that which would exist if, five years after starting to implement the government proposals, the income distribution in the fifth year was identical with that of 1969 and the revenue needs of the government had remained unchanged between 1969 and 1974.
2. In reality, over the five year interval, one may assume in the light of recent experience, not merely a probable total growth of about 25 per cent in real incomes, but also a significant re-distribution of those incomes as between the various income brackets. Superimposed upon the effects of a rising G.N.P. will be a continuous rise in prices. The general level of incomes between 1969 and 1974 would be rising and, on the assumption of existing, i.e. 1969 rates of tax, tax yields would have risen proportionately more than incomes.
3. The justification for the above analysis is demonstrated in the following passage from the Sixth Annual Review of the Economic

Council of Canada Perspective 1975. Thus: "Total revenue is expected to increase at an average annual rate of more than 9 per cent to 1975, somewhat faster than the increase in G.N.P."¹ This "is due largely to the fact that the progressive rate structure of personal income tax, the largest single contributor to government revenues produces increases in revenue that are proportionately greater than advances in income" (op.cit. p.48).

4. Yet, even for their declared purpose the credibility of Tables 15 and 16 is difficult to assess, but it can hardly be great, considering the series of assumptions and estimates that are involved. The White Paper notes among many other caveats that it is "hazardous to forecast revenues; for example, the estimates of corporate profits are more difficult to forecast because they depend on changes in production, prices and costs, which interact in an almost limitless number of ways" (para. 8.4). Quite apart from such general observations, the Paper records that the "hazards of forecasting are increased when major changes are made in the tax structure."
5. For this reason, "it is necessary to know, to assume or to forecast on the basis of partial data, a number of factors that have not previously borne directly upon tax yields and are not reflected in tax statistics or other economic statistics. It is also necessary to forecast reactions of taxpayers when confronted with new opportunities or new limitation on their behaviour" (8.5). These sections conclude with the observation that "these risks are particularly important in connection with the current programme" (8.5).
6. In the light of the foregoing observations, the statement (para. 8.6) "We believe that the forecast of total revenue on the basis of 1969 incomes, with all the changes proposed, is subject to only a modest error, at most a few per cent, and is not biased in one direction or the other" (my italics) is, to put it charitably, optimistic.² When, however, the more detailed assumptions involved in making estimates
 1. G.N.P. calculated on the basis of full potential growth in the Canadian economy estimated at 5.5 per cent per annum.
 2. Even a 5 per cent error in the income tax yield could represent a possible addition to the taxpayer's burden of over \$350 m!

of the individual components which go to make up the total revenue changes over the five-year period are considered - and these are set out between paragraphs 8.7 and 8.50 - one can only marvel at the optimism of those responsible for these calculations. It is little wonder, since a change in any one of the key assumptions will alter the result, that the revenue estimates of the Ontario Government are so widely different.

7. What the White Paper should have shown was the distribution of income and consequent tax burden expected, as a result of implementing its proposals, to emerge at the end of the five year period. For this purpose, estimates need to be made showing the effects on income distribution of changes in the price level and a rising gross national product. Given the resultant income distribution and assuming constant 1969 rates of tax, the probable changes in the weight of taxation on the various income groups could be estimated. Such an exercise would involve no greater degree of estimation than that entailed in the compilation of Tables 15 and 16. But, its results would have been infinitely more relevant to the question which every taxpayer who reads the White Paper is asking, i.e. how will the proposals ultimately affect people in my income bracket?
8. The fact that the White Paper does not include such an exercise is at best regrettable and, at worst, must be interpreted as reluctance to reveal the full implications of the proposals. As they are currently presented the attractions of the White Paper proposals lie in the elimination of the lowest income groups from tax and the modest increase in the liabilities of those persons in the highest income brackets, as set out in Tables 5 to 10.

Three criticisms must be made of this 'picture'. The first is that the statistical basis of the results must be regarded with considerable reservations. The second is the picture is largely irrelevant because the distribution of incomes and, therefore, of taxation will be quite different in five years time. The vast majority of taxpayers will be in higher income groups; if we assume no more than 4 per cent annual growth in money incomes, the general level of money incomes will be virtually 25 per cent higher and, to this extent, incomes will be

attracting significantly higher rates of tax.

9. This is precisely the reason why inflation is so useful to any Minister of Finance. As incomes rise, so the marginal income attracts a rate of tax higher than the average and the increase in tax revenues exceeds the growth in incomes. This is the point made by the Economic Council in its 6th Report; - "the progressive rate structure of personal income tax, the largest single contributor to government revenues, produces increases in revenue that are proportionately greater than advances in income."¹
 10. The third criticism stems from the fact that Tables 5 to 10 are concerned solely with employment income. The wider impact of the White Paper proposals arises from the broadening of the income tax base to include capital gains and also expenses currently deductible. What needs to be noted is that, in contrast with the estimated reduction of \$35 m. in the prospective yield of the personal income tax to \$7,685. (para. 8.5), the prospective yield of the capital gains tax in respect of persons alone is \$345 m. (Table 15). The bulk of this additional revenue will come from the higher income groups.
 11. It may be argued that, as tax revenues rise (due to 'built-in' progressivity) the rates of tax will be reduced. Any such reduction is highly unlikely. It is demonstrably improbable for one obvious and simple reason, i.e. the prospective financial needs of the Federal and Provincial governments. The Sixth Review of the Economic Council makes this point very clearly. Thus, "the rate of increase in expenditure on goods and services by all levels of Government would be higher over the 1967/75 period than in 1961/67 and higher than the increase in real G.N.P. Governments will thus be absorbing a larger share of the nation's total output in 1975 than in 1967" (p. 16).
 12. The prospect is even more depressing when note is taken of two major conditions which determine the prospective level of governmental spending and its financing. Whereas there is no doubt that governmental outlays at all levels will tend to increase rapidly during the
1. pp. 48-9, Table 3/9. See also the exposition of this feature of the progressive income tax in Federal Tax Revenues at Potential Output. 1960 and 1970, by D.J. Daly.

1970s, it is by no means so certain that the rate of economic growth postulated by the Economic Council as desirable, i.e. at full potential, will in fact be achieved.¹ To the extent that the rate of increase in governmental expenditure exceeds the growth rate of the economy, higher taxes are inevitable.

13. This conclusion is so significant a consideration in assessing the White Paper proposals that it merits more than mere re-statement. The next few paragraphs culled from the Economic Council's Sixth report should make the issue clear beyond any dispute. Thus, "it is anticipated that government revenues will advance very strongly as the economy moves to potential output in 1975. On the assumption there will be no general advance in tax rates beyond those in effect in the spring of 1969, total government revenues would also approximately double between '67 and '75."² However, "a large proportion of this fiscal dividend would be pre-empted by expansion of existing government spending programmes." "Our estimates involve some increase in the relative size of the government sector of the economy. Governments will be absorbing or redistributing about 37 per cent of the nation's total income by 1975, compared with 33 per cent in 1967."³ (p. 26).
14. Elsewhere the Sixth Report comments: "Even if government activities were to expand sufficiently to provide only existing standards

1. On this point see the reservations in the Sixth Review, pp. 19-21 and comments thereon by two University teachers, Messrs. J.R. Allen and J.J. O'Callaghan in the Canadian Tax Journal, Nov.-Dec. 1, 1969, pp. 434-5 and 437.
2. Op.cit., p. 25. This figure rests on the highly unrealistic assumption (see Report, p. 19) that the annual increase in prices for total government expenditures will average about 2 per cent until 1975 (see p. 48, op.cit.). In money terms revenues could be higher as the result of inflation, but this could be offset by the failure of the economy to grow at its full potential.
3. Messrs. Allen and O'Callaghan refer to Dean D.W. Slater's estimate that an increase from 33 to 37 per cent in the public sectors share of the G.N.P. "would require the absorption of approximately 45 per cent of the total increase in output between 1969 and 1975!" (op.cit. p. 435).

(author's underlining) of services for an increasing population, substantial increases in spending (author's underlining) would be required in many fields. The most rapidly growing part of the population in the coming decade will be the young adult group, those at the stage of family and household formation. There will also be a substantial increase in the numbers of school age children, while the over-65 group will grow somewhat more rapidly than total population through the 1970s." (p. 31). And, later in the Report:- "Transfer payments are also expected to grow more rapidly than G.N.P. Transfers to hospitals is now largely reflected in government expenditures on goods and services. Substantial increases are projected for transfers to universities, in social assistance payments in the Canada Assistance Plan, and benefit payments in the Canada and Quebec Pension Plans." (p. 50).

15. The problem is more serious than these figures and quotations may suggest. Major relief for the Federal government taxpayer in recent years has been provided by the very substantial savings in respect in military expenditure. These have dropped from "more than one-third of all government expenditures in 1952" to "less than 9 per cent by 1969."¹ The savings in this major area of expenditure have enabled the Federal government to finance growing areas of socially desirable expenditure without sharper increases in taxation. There is an obvious limit to further savings in that area and, more to the point, there is no area of current expenditure where cuts commensurate with future revenue needs are possible. Hence the emphasis is laid by both the Economic Council of Canada and the Tax Structure Committee (Feb. 1970) on the need for cost effectiveness and reviewing all expenditure programmes.
16. The foregoing facts are major determinants in the entire fiscal situation. And, should the growth rate in the economy not reach full potential (and it will be remarkable if it does) then the tax rates must rise sharply because, for all the talk of economy and control of governmental expenditure, it will not be feasible on

1. Report of the Tax Structure Committee (Feb. 1970, para. 18).

either social or political grounds to defer urgently needed government expenditures in the fields of education, health, and housing.¹ Yet the White Paper completely ignores the implications of these crucial considerations.

c) Provincial - Municipal Revenue Needs

(Since this memorandum was prepared, the Report of the Tax Structure Committee to the Federal - Provincial Conference of Prime Ministers and Premiers (Feb. 1970) has become available. It is noteworthy that this official document reiterates all the points made hereunder. For this reason, it has not been felt necessary to revise the following text except to add references to the 1970 Report.)

1. According to the Economic Council: "Even without allowing for major new expenditure programmes, government expenditure will almost double again (as it did between 1961-8) to \$43 billion in 1975" (op.cit. p. 25). The recent contribution of the Provincial and Municipal authorities to this growth is evidenced by the Hon. M.W. Sharp, then Minister of Finance, in the Report of the Federal-Provincial Tax Structure Committees, September 1966: "Since the early 1950s Provincial and Municipal expenditures have increased from an amount equal to less than half of Federal expenditures to an amount greater than the total amount the Federal Government now spends. The Provincial use of major tax fields has grown correspondingly." (op.cit. p. 14).
 2. The outlook for the future, continued the Minister in Sept. 1966, indicated a number of trends. "First, Provincial/Municipal expenditures will continue to rise more rapidly than those of the Federal Government. Secondly, Provincial and Municipal expenditures will also rise more rapidly than will their revenues from existing taxes. Thirdly, Federal Government revenues from existing taxes, on the other hand, are expected to grow at a rate more nearly equal to the pace at which its expenditures will increase." (p. 15).
 3. "The real problem confronting us," continued Mr. Sharp, "if we are to take seriously the projections of Government revenues and expenditures, is how the Federal, Provincial and Municipal Governments - and
1. See Sixth E.C. Report, pp. 30-38.

particularly the Provincial and Municipal Governments - are going to finance their continually rising expenditures. This in turn leads to the difficult question as to whether the Provinces have access to sufficient revenue sources to finance these increasing expenditures."

The 1966 Report concluded from a review of the relevant facts that the Provinces have "access to revenue fields capable of yielding the required revenues" (p. 23). The problem, however, noted the Report, "is not a lack of access to revenue resources, but rather the difficulties the Provinces face - in company with the Federal Government - in raising tax levels that are already high." (p. 24).

4. Between 1958-59 and 1968-69 total tax revenues of the Provinces rose from \$1,010 m. to \$5,594 m. The fastest growing single tax, in terms of revenue, was the personal income tax. This yielded \$48 m. in 1958/59 and an estimated \$1,720 m. in 1968-69. From producing just over 2 per cent of the total net revenues of the Provinces, the income tax contribution has increased to over 20 per cent.¹ Since in the latest year 68 per cent of Provincial revenues were derived from taxes, the significance for future tax rates of the prospective growth in Provincial and Municipal expenditures is self-evident.
 5. Already five Provinces (Newfoundland, New Brunswick, Manitoba, Saskatchewan and Alberta) impose a rate of personal income tax which is higher than the rate abated by the Federal government, i.e. 28 per cent. Even in 1966 it was clear from the remarks of the then Minister of Finance that the Federal government was not prepared to relinquish its claims on the personal and corporate income tax fields. Even then it was becoming necessary that each level of government should take into account what the others were doing and seek to "harmonise" their tax policies "to ensure that the interests of the taxpayers in Canada are protected". There is no tangible evidence as yet to suggest that the prospects for harmonisation are improving. The White Paper's contribution is the platitudinous remark that "a major concern of the government ... will be to
1. Tables 16 and 17, Provincial Finances 1969, published by the Canadian Tax Foundation. The same point is made in the Report of the 1970 Tax Structure Committee (op.cit. para. 12).

maintain the high degree of coordination which has been achieved in recent decades between the Federal and Provincial tax systems" (para. 7.1) and, for the present, to abandon the "standard abatement".

6. Some indication of the extent to which the White Paper proposals make that coordination imperative is provided by the statement of the Ontario Treasurer on the government's reform proposals. The Hon. Charles MacNaughton's remarks to the Tax Structure Committee meeting in December 1969 on two important points reveal a greater degree of awareness of the fiscal facts of life in Canada than is evident in much of the White Paper.¹ First, he noted that Ottawa "has staked its claim" which "clearly implies limitations on the future use of the personal income tax field by the Provinces, unless Ottawa reduces the Federal rates set out in the White Paper."² Given the facts set out in the previous section of the memorandum it is very doubtful Ottawa could restrict its claim on the income tax.
 7. Second, since the Provinces' needs for revenue are growing faster than those of the Federal Government, unless the Provinces can also make increased use of the personal income tax field, they will be forced to rely upon "property taxes, sales taxes and health insurance premiums, all of which bear heavily on low income citizens."³ Such a policy for the Provinces and Municipalities would be the reverse of fiscal equity. To satisfy the mounting revenue needs of the Provinces and Municipalities in this way would exacerbate the inequities inherent in these particular taxes. It would then become necessary to increase their reliance upon the much more equitable income taxes, unless the governments were prepared to rely upon inflationary deficit-financing. This would mean, since Ottawa is unlikely to relinquish any of its
1. The Tax Structure Committee paper 1970 reflects a similar degree of awareness of the dangers of the present situation, if only by limiting its projections to 1971-72. It does, however, re-iterate the Economic Council Review's estimates for 1975 as set out in the previous section of this memorandum.
 2. On the assumption that the combined rates do not exceed 51.2 per cent.
 3. Ontario statement, p. 7.

share of the income tax yield, that combined Federal and Provincial income tax rates would ultimately be in excess of those proposed in the White Paper.¹

8. A moment's reflection makes it clear that, in circumstances where regressive indirect taxes had been exploited to the full by the Provinces and Municipalities, the top marginal rate of 50 per cent would be the first victim. Taxpayers in the lower income brackets would be quick to point out, without regard for differences in the tax bases, that the Canadian rate was well below the U.S. or U.K. top rates. Given the number of votes at stake on both sides of the fiscal fence, it is not difficult to predict the outcome. The first result would be an increase in the top rate of income tax despite the fact that the proposed limit of 50% on personal income taxes is a keystone of the White Paper package designed to balance the widening of the income tax base.
9. However, raising the top rate alone would not suffice to meet total governmental revenue needs. It would be necessary also to increase the rates applicable to the middle income groups. As the earlier quotation from Professor Shoup noted, the rich alone cannot meet the demands for increased revenue. The main burden must inevitably fall on the much more numerous middle income groups which constitute a particularly important section of the Canadian economy.

1. The Tax Structure Committee effectively makes this point very clear; see para. 34-36.

PART A - ECONOMIC STUDIES OF THE WHITE PAPER PROPOSALSNO. 2 - ECONOMIC IMPACTa) Selected Issues

1. The most important aspect of the White Paper proposals lies not in their similarity to the corresponding Carter Commission recommendations, but to their obvious dependence upon the economic foundations of the Carter Report. The highly optimistic assumptions regarding the effectiveness of future Canadian economic policy, which characterised that Report, were examined in the submission of the Vancouver Board of Trade to the Minister of Finance on the Report of the Royal Commission on Taxation. They were even more forcefully criticised by Dr. Neil H. Jacoby of the University of California in his critique of the Carter Commission report entitled Canada's Tax Structure and Economic Goals.¹ The White Paper barely acknowledges that any such criticisms exist; still less does it seek to answer them!
2. The impact of fiscal changes is likely to exert itself primarily through the effects on incentives. The White Paper takes the view that, because of the substantially lower top marginal rates, the disincentive effects on the willingness to earn save and invest, and consequent economic effects, are not likely to be significant. In the case of the higher income brackets, where dividend income is important, the proposed tax credits may substantially alleviate the tax burden of capital gains.² It cannot be assumed, however, that the recipients of large investment incomes are the same taxpayers who receive large capital gains. On the other hand, there is a very real danger that, once it becomes apparent that persons in the higher income brackets derive substantial advantages from the dividend credit, there will be political pressure on the Government to make changes. It is such considerations, already noted in connection with the 50 per cent rate in the preceding section, that leads to reservations concerning the longer term realism of the White Paper proposals.
3. Generalised assertions on disincentive effects of tax increases on taxpayers are virtually impossible to substantiate. Research work

1. Published by York University, Faculty of Administrative Studies, Oct. 1967.

2. This is evident from Table 15B-2 in the Ministry of Finance paper dated March 6, 1970 (70-28).

done for the Carter Commission led to the conclusion that disincentive effects of high tax rates, particularly in respect of willingness to earn, were exaggerated. Unfortunately, such claims do not explain why it is that in countries where tax rates are high, so much effort is devoted to the development of avoidance techniques; to business policies designed to mitigate tax and finally, particularly among businessmen, the exploitation of tax-free fringe benefits. It is noteworthy that even the White Paper (para. 2.39) concedes that "there is a danger that rates higher than 50 per cent applied to earned income ... would lead to some slackening of effort and a desire to take benefits in non-productive ... and less taxable forms."

4. In view of the proposed modest increases in tax on earnings above \$15,000, assertions of disincentive are considerably weakened for the majority of taxpayers. Nevertheless, it is highly unlikely that significant changes in the treatment of certain types of income, e.g. capital gains and business expenses, will not have some effects on particular groups of taxpayers and consequent repercussions upon the economy. There are four issues which merit particular attention in the context of the White Paper proposals. First, there is the reaction of persons in the middle and higher income brackets who have a high degree of job mobility and might be tempted to move to friendlier tax pastures. Second is the effect upon savings - corporate and personal - and the capacity to accumulate investible capital, with particular reference to the small businessman. Third is the probable effect upon investors and investment policies of the proposed capital gains tax. Finally there is the question of the effects upon industrial investment, particularly in the resource industries which even the White Paper admits will be far less favourably treated.

(i) Personal Tax Incentives

5. As far as individual taxpayers are concerned, if the White Paper proposals are implemented, tax even on middle incomes appropriate to executives will be significantly higher in Canada than in the United States. Inter-country comparisons are notoriously difficult to make

and there is no point in dwelling upon them here.¹ It is, however, incontestable that the position of the married taxpayer in Canada will be less favourable for any income between \$10,000 and \$25,000, a fact conceded by the Canadian Department of Finance in the document White Paper Highlights.² It seems, however, that those figures significantly underestimate the disparity in the tax burdens in these two countries. A particular benefit to American taxpayers in the upper income brackets is to be found in the practice of income splitting, which is of especial value to the married man. A paper prepared by a leading firm of Canadian Chartered Accountants, suggests that even on relatively modest gross incomes of \$12,000 and \$25,000 the tax for a married man under U.S. taxation would be 31 per cent and 28 per cent lower respectively than the Canadian liability. If the U.S. Tax Reform Bill of 1969 is put into effect, then those differences become 42 and 36 per cent respectively.³

6. Admittedly, there are many factors other than taxation which persuade a man to move abroad for his employment. Nevertheless, given the proximity and similar pattern of life in Canada and the U.S.A., this ever-present mobility could become a serious matter. Canadian industry might seek to counter the attractions of American tax rates by increasing gross salaries and passing on the costs thereof, as far as possible, in higher prices of their products, but this too would not be in the best interests of the economy.
7. The final outcome in this contentious area cannot be predicted. All that can be said is that, given Canada's need to retain the services of its most able citizens, every care should be taken to avoid generating such pressures upon them that they incline to seek their fortunes outside Canada. The White Paper proposals meet this point only on the most optimistic assumptions. As argued in the preceding section, one major assumption relating to ultimate tax rates, is

1. They are discussed in an article in the Canadian Tax Journal, Jan/Feb. 1970, by David B. Perry.

2. And confirmed in David B. Perry's paper (op.cit.).

3. This paper is reproduced in its entirety in Study No. 2 of Part B of this brief.

virtually certain to be unfulfilled.

8. On the impact of the tax reform on savings, the White Paper is particularly optimistic. It anticipates no more than a reduction of some \$525 million in a total of some \$14 billion; in other words, about 4 per cent.¹ Personal savings in Canada have always been high and any analysis of the effects on savings turns on two particular aspects. The first is how far the taxation of capital gains will offset the very favourable dividend credit for the middle and higher income groups and thus reduce the pace of saving. The second concerns the abolition of the preferential treatment of the small business by charging the first \$35,000 of profit at the standard 50 per cent rate instead of the existing preferential rate of 21 per cent.
9. On the first issue time alone will tell. Figures in Table 15B-2 in the Ministry of Finance letter (op.cit.) suggests that for all income brackets above \$10,000 the tax contribution in respect of capital gains (less losses) exceeds substantially the gain to the taxpayer from the integration of personal and corporate income tax. In the same income brackets there is a further addition of tax from the taxation of deemed realised gains on widely-held stock.² In contrast, the averaging provisions offer relatively little relief.

If the predictions concerning future rates of tax set out in the two previous sections are borne out, then there may well be more serious adverse effects on the overall level of saving; more, that is, than the White Paper allows for. Furthermore, the impact of these higher taxes is not evenly spread across the taxpaying community. The adverse effects are likely to be concentrated among precisely those sections of the community which are accustomed to save and invest, i.e. the middle and upper income brackets. Such considerations become of crucial importance in the light of comments by Messrs. Allan and O'Callaghan who emphasise the need between

1. It is difficult to know what reliance can be placed upon these estimates without knowing the detailed assumptions upon which the calculations are based.
2. These figures based on 1969 incomes and derived on the basis of the many arbitrary assumptions set out in the White Paper must be treated with reserve.

1969-75 for "substantial increases in investment in business plant and equipment, inventories housing and sound capital" which will require the "generation of an extremely high rate of growth of savings". (op.cit. p. 438).

(ii) Taxation of the Small Business

10. There are very real difficulties, economic, finance and political, in devising the optimum tax treatment of the small incorporated business. The Canadian economy is still heavily dependent on the activities of many small business men. It is generally conceded that the efficient small business man is often a considerable innovator and his business may constitute the beginnings of a future large undertaking. All Governments wish to encourage the small business man, but it is arguable that the present tax concession is not the most effective means.
11. The main effects of the tax change upon the small incorporated business will be its capacity to accumulate capital. It is noteworthy that in the U.K. the main complaint from small businesses relates to the difficulty of obtaining sufficient capital for the development of the business. This affects most the vigorous thrusting company seeking expansion.¹ In part this might be offset by more generous provisions for writing down capital equipment, but when the higher rate of tax is combined with the proposed restrictions on expenses the impact on the small business of the proposed changes could be sharper than upon any other section of the community.² On the other hand, it can be argued that if the small business is really successful, e.g. profits over \$35,000 per annum, its owners will benefit from the "reform". Against this benefit, however, must be weighed the potential liability to capital gains which, for a successful business, would be heavy.

1. See, for example, the evidence of the C.B.I. among other interests, to the Bolton Committee of Enquiry into the Small Firm currently taking evidence in the U.K.
2. The revised treatment of the resources industries is ignored for this comparison.

12. There is a strong social as well as economic case for encouraging the small independent business. The White Paper proposals, however, would leave the owner no better off than the Government official or paid executive in the large organisation. In other words, he gains nothing, apart from precarious independence, from exercising his initiative and seeking to utilise his capacities independently.
13. A major reason for eliminating the preferential treatment for small businesses, and it is not denied that this has been preferential, has been the extent to which the provision has been exploited for tax avoidance purposes. It should be stressed, however, that avoidance will arise in any fiscal system. There is, for example, already considerable discussion concerning the possibilities of switching between closely and widely held corporation status as a means of limiting capital gains liability. If this becomes a practical proposition, the discriminatory treatment of gains from assets such as widely-held stock will be extended. This will be inequitable vis-a-vis other types of assets. There is every prospect that the tax differential between gains from closely and widely held corporate stock will constitute an important incentive and avenue to avoidance.
14. The treatment of the small business man is ultimately a matter of judgement rather than of economics. He constitutes an important element in the Canadian economy. According to the Ministry of Finance letter (op.cit.) 90 per cent of taxable corporations operating in one province only have taxable profits of under \$35,000. The figure for Ontario is 89 per cent, but that for British Columbia is 96 per cent and over 62 per cent (8650 out of 13763) of this number have profits below \$10,000. In other words, the importance of the small business in the infra-structure of some provinces is greater than that in others and the White Paper proposals thus discriminate more against some regions than others. Unlike its American and British counterparts, Canadian industry is not dominated by the concentration of economic power in the hands of one or two concerns. The contribution of the small firm is therefore of considerable importance. In short, the desire for fiscal equity should not be allowed to override all other considerations. Further-

more, the government might well find a tax concession to such businesses less expensive than an extension of the activities of a government-sponsored institution or guarantees to the banking system created for the specific purpose of providing loans to the smaller business.

(iii) Capital Gains Taxation

15. The economic and investment consequences of taxing capital gains are still a matter for debate among economists. Nevertheless, it is reasonable to assume that, as with any tax which reduces the post-tax return to an investor, there is some lessening of incentives. In his study for the Carter Commission Professor G. Conway concedes that the "burden of tax on capital gains would partially (my underlining) fall on savings" (p. 17) and adds (p. 19) "the taxation of capital gains in the U.S.A. does not appear to have retarded development in the country".¹ This is a most unfortunate statement since it suggests by mere inference that the White Paper proposals will leave the forces contributing to economic growth in the Canadian economy unaffected. This can only be true on two assumptions. First, that despite higher taxation the Canadian economy will display the same dynamism as in the past and second, that the Canadian proposals for taxing capital gains are in their essentials and consequences no different from those in the States.
16. Even if one were prepared to accept the highly dubious first assumption, the second proposition is quite untenable. For nearly thirty years American taxpayers in the higher income brackets have enjoyed a very significant differential as between short and long term rates. The 25 per cent long term rate is highly preferential and of considerable benefit to those in the higher income brackets in the States.
17. A particular factor in reducing significantly the adverse effects of the U.S. tax has been the exemption from capital gains tax of assets held until death, when revaluation to the benefit of the legatee takes place. This particular provision, many would call it

1. The Taxation of Capital Gains, No. 19.

a major "loophole", has markedly affected investment behaviour in the States. Since the degree of wealth tends to be highly correlated with age, this particular provision has made it possible for older investors to defer realising their gains and thus to escape tax at death for the benefit of their legatees. In particular, it has also enabled many families to retain control of closely held companies since the shares pass at death without liability to tax.

18. There is evidence in the U.S.A. of the 'locked-in' effect but American economists are evenly divided regarding the extent to which capital gains tax has 'locked-in' investors. There is certainly no clear-cut evidence, on this issue, even after thirty years, sufficient to justify the arbitrary taxation of accrued gains for one class of investors. In the U.K. after five years, there is some evidence of a locked-in effect, while investors are adjusting themselves to the existence of the new tax. The psychological effect of the relatively new tax has undoubtedly been initially to discourage liquidations. In other words, no one can predict the investors' probable reactions to capital gains taxes, least of all with a completely new style of tax as proposed in the White Paper.
19. A full discussion of the White Paper proposals for taxing capital gains would require a treatise nearly as long as that prepared for the Carter Commission by Prof. Conway.¹ It is the theme of this commentary on the White Paper proposals relating to capital gains, however, that in view of their unpredictable economic consequences the White Paper proposals should be substantially modified.

(iv) Resource Industries

20. The sharpest impact of the Government's proposals will be made on certain of the resources industries. The reason is that the resources industries, in particular minerals, have hitherto been afforded significant tax incentives. The Carter Commission concluded that preferential treatment led to distortion in the allocation of resources. On this point, Mr. Hugh J. Aitkin in his study American Capital and

1. However, see Part A - No. 3 for more detailed comments.

Canadian Resources¹ has written (p. 121) "the expansion of the resource industries which underlies Canada's current economic development has not had the effect of inhibiting or retarding the diversification of the economy. In fact, quite the contrary appears to be the case." The resource industries are well able to make their own case but, in view of the importance of these industries in the infrastructure of British Columbia, with which the Vancouver Board of Trade is especially concerned, three points must be emphasised.

21. The first and most important is that within the Canadian economy the contribution of the mining and oil industries is considerable. They are a major source of foreign exchange for Canada and as such constitute a significant element in stabilizing the balance of payments. In view of the importance of maintaining external stability, it would be unwise to do anything which might jeopardise the capacity of these industries to earn foreign exchange. However desirable it may be to achieve a greater diversification of Canadian exports, policies likely to affect adversely the development of the resource industries do nothing to help this goal.
22. A second consideration arises from the fact that these resource industries have traditionally relied, not so much on domestic capital, but upon foreign investment. This has grown remarkably in response to American industrial need of Canada's resources. The dependence of the Canadian economy upon imports of foreign capital to keep its external accounts in balance is well known. Any form of apparent discrimination, as is implicit in the capital gains tax proposals for widely-held shares in Canadian companies, or reduction of tax incentives as are proposed in the White Paper, must affect adversely in some degree the readiness of foreign capital to come to Canada.
23. Third, the significance of the foregoing points is underlined when it is realised just how important is the role of the resource industries in the development of the Canadian economy. Such investment exerts multiplier effects and generates demand for secondary industries. Finally, one of the major benefits to be derived from foreign

1. Harvard University Press.

intervention in the economic life of the community is the inflow of skills, in particular managerial skills. As Aitken (op.cit. p. 104) has commented, "American capital, entrepreneurship and technology have not merely exploited opportunities, they have also created them."

24. In short, Canadian governments may have offered incentives to these industries in respect of taxation, but it can hardly be denied that the Canadian economy (and not least the Department of National Revenue) has been a major beneficiary. The prospects of development in the Northern Territories will probably depend largely upon the willingness of foreign investment in the resource industry to open up these areas.¹
25. Nor can it be assumed that any diminution of interest by foreign capital in the resource industries will be made up for by domestic investment. As Aitken has pointed out, "Canadian capital has shown a preference for the safer forms of investment" (op.cit. p. 120). Furthermore, given the uneven distribution of the resources industry throughout Canada any reduction in the scale of its activities, which the White Paper proposals might generate, will affect some Provinces more sharply than others. In this respect, British Columbia has a special interest in the matter. If there are to be any adverse results from these particular proposals, they will be felt in British Columbia before they affect Ottawa.
26. For British Columbia, resource development whether it be financed by American, Japanese or local capital, means greater employment opportunities, larger payrolls, a more diversified economic infrastructure and a larger tax base. In recent comments on the White Paper one Provincial minister has already hinted that his Province might consider exempting capital gains to encourage investment. An alternative inducement would be for a Province such as British Columbia to make some corresponding tax concession to ensure that the recent influx of overseas capital was encouraged. Such divisive fiscal policies would, however, be incompatible with the existence of a unified economy.

1. See Third Economic Council Review, p. 262.

27. It is not denied that the White Paper proposals for the taxation of the resource industries in a mature economy are reasonable, just as the existing concessions offered a substantial incentive. There are times within a given framework of economic development, however, when subjective assessments of fiscal equity should be compared with the very real advantages realised from ignoring theories of tax neutrality. And, this is even truer when the outcome of any measure is so difficult to predict and the consequences of erroneous judgement so serious. However desirable it may be to diversify the Canadian economy, tax proposals which could retard the growth of the resource industries conflict with the basic tenets of the economic law of comparative advantage. In other words, Canada cannot produce manufactured goods as inexpensively as the U.S.A. or Japan; it can, however, buy these goods at lower real cost by the exports of its resource industries, which it can produce relatively more efficiently.
28. According to the White Paper "the tax reform proposals set forth in this paper are expected to have relatively modest impacts upon the Canadian economy apart from the effects on savings in closely-held companies and possibly on investment in the mining industry". This reassurance does not of itself guarantee such 'modest impact'. Given the present problems of the Canadian economy and its stage of economic development, few would assert that it is a suitable subject for untried theories of fiscal reform which exert such all-pervading effects.

b) General

1. Taxation is not concerned merely with meeting the Government's need for revenue. In every developed economy governments use budgetary and fiscal policies to pursue a number of objectives other than the raising of revenue. The most important of these are:-
- (i) the stimulation of economic growth to raise living standards;
 - (ii) the checking of inflation within the economy;
 - (iii) the maintenance of a high and stable level of employment;
 - (iv) the encouragement of balanced regional and industrial development;

(v) the re-distribution of income and wealth.

All these objectives are implicit in the White Paper. Few citizens would dispute the desirability of achieving the first four, even if some may have reservations on the last. Mere affirmation of these goals, however, does not signify their attainment; in fact, some of them are in conflict. For example, dis-inflationary policies tend to depress the rate of economic growth.¹

2. The objectives are also in conflict because, as Professor Shoup points out, the means available to achieve any one or more of these objectives are not so efficient as economists could wish.² Both in Western Europe and North America, governments have learned that "finger-tip" control in economic affairs is a myth. Thus, having made its decision as to which particular objectives priority should be given, a government can at best only estimate the probable consequences of its policies. This is especially true for a country which is as exposed to external economic forces, as is Canada, given its heavy dependence upon foreign trade and finance.
3. There are indications within the White Paper that the authors are aware of some of these problems, but it is implied that their proposals are designed so as to avoid any significantly adverse consequences. The authors recognise for example that taxes should not "unduly" (my underlining) inhibit the incentive to work and invest" (para. 1.10). How does one know what type of taxes and what rates will unduly inhibit these incentives? No one knows, although by emphasising the moderate top 50 per cent rate of income tax, the existence of rates which do inhibit incentives is conceded and attention is distracted from the possible consequences of the relatively severe treatment proposed for capital gains.
4. It is also stated that "investment needed for productivity and public purposes should not be rejected ... just because of the tax con-

1. See, for example, Third Annual Review of Economic Council, pp. 195-200. Note too the discussion in the Report of the Royal Commission on Banking and Finance 1964, pp. 419-22.

2. See Public Finance, p. 480, section headed "Conflict of Goals." Weindenfeld and Nicolson.

sequences" (1.10). The fact is that they often are, since businessmen must and do consider the tax consequences of any proposed policy.¹

5. It is generally agreed that persons in high income brackets should pay proportionately more of their incomes in tax than those less well-off. But how much more? As the White Paper notably concedes, "there is no single or simple rule for increasing the rates up the ladder that can be said the 'right' way". It is, observes the White Paper, "a matter of opinion, of judgement" (1.9). The Government can hardly complain if readers of the White Paper proposals for increasing the progression of taxes on personal incomes suspect that the Government's opinions and judgement on this particular issue may be at fault.
6. Economics is not an exact science, hence, in the field of policy formulation there is scope for wide differences of opinion. For example, the Government's primary objective is 'equity', i.e. fairness between taxpayers. There are no criteria in taxation matters which enable either economist or politician to indicate with precision what is 'fair'. What constitutes the appropriate degree of 'equity' in any tax system remains a matter of personal opinion. Thus, in demanding fiscal 'equity', the economist may stress the importance of maintaining consumer demand; in contrast, the industrialist may be concerned to ensure that capital will accumulate in the hands of personal savers, while the politician may believe that emphasis on equity will earn his Party more votes.
7. Nor are economists, any more than politicians, able to predict the impact and results of fiscal policy upon the economic life of the nation. The re-distribution of income and wealth consequent upon the White Paper proposals will undoubtedly have some effects on the incentives of persons in the middle and higher income brackets to save and invest. On the other hand, as Professor Shoup has pointed out, "the rich do not possess enough in the aggregate to help the poor a great deal; if the poor are to gain through the public finance system it must be at the expense, largely, of the middle income and

1. See for example, examples given by Professor C. Shoup in Public Finance, p. 333.

lower-middle income classes."¹ This fact is all too evident, even on the basis of 1969 data; given a few years of inflation and rising incomes it will become even more evident.

8. On all these issues, as with the decision to assign to 'equity' a higher priority than other objectives of fiscal policy, a judgement has finally to be made. The Government may believe that the Carter Commission evaluations upon which these White Paper proposals are based were sound and need no further justification. Unfortunately, circumstances and conditions in a nation's economy change too rapidly to justify overmuch faith in policy recommendations often based on a subjective evaluation of inadequate data analysed by econometric techniques. The results of such analysis are largely dependent on the number and relevance of the time series available which are incorporated into mathematical relationships with constants based on observed events of the past.² The mere fact of introducing a new variable, e.g. a new tax, may affect consumer or investor behaviour to an extent that the analysis becomes either irrelevant or even misleading. Unfortunately, the spurious precision of econometric logic can all too easily lead to uncritical acceptance of the results.
9. Whether or not the effects of this re-distributive policy will be, as the White Paper implies in the light of the Carter Commission researches, only marginal or whether they will, as some critics fear, significantly affect the growth rate in the Canadian economy, is a matter for debate. That debate, however, concerns the future of the Canadian economy and the living standards of its people.

1. In *Public Finance*, op.cit., p. 328. A similar point is made in "Fiscal Policy and Economic Development" in Readings in Taxation in Developing Countries by R. Bird & Oldman, Johns Hopkins University Press.

2. The Power of Economic Growth. No. 24 of the Royal Commission Studies provides an excellent illustration of both the value of this type of analysis and its limitations as a guide to policy.

PART A - ECONOMIC STUDIES OF THE WHITE PAPER PROPOSALSNO. 3 - THE TAXATION OF CAPITAL GAINS

1. The lynchpin of the White Paper proposals is the inclusion of capital gains in the income tax base. It may, for three reasons, be regarded as the sine qua non of the Government's scheme. First, it constitutes a fundamental re-definition of the personal and corporate tax bases. Second, it comprises a significant element in the estimated revenue resulting from the proposed changes. Third, these proposals will affect the ownership of wealth and, in the longer run, will exert significant re-distributive effects.
2. In the economic sphere, there are basic weaknesses in the White Paper proposals:
 - (i) the estimates of future revenue rely heavily upon the U.S. experience in taxing capital gains. Since Canadian taxpayers' behaviour is likely to be different, at least initially, and since the proposed Canadian tax is very different from the U.S. model with harsher effects on some investors, such an extrapolation of revenue expectations is at best irrelevant and at worst misleading.
 - (ii) Implicit in the proposals is the belief that the consequences of the tax on taxpayers and investment behaviour will not be significant. Such faith, dependent largely upon economic theorising, has a habit of being misplaced in the real world.
 - (iii) The implications of inflation for capital gains taxes are much more serious than the White Paper concedes. It must be remembered that while the term "equity" may mean one thing to the academic economist, it tends to be differently interpreted by the taxpayer who is highly conscious of the impact of inflation on his affairs. It is for this reason that most governments which tax capital gains adopt either a low preferential rate or ignore gains realised after a given holding period, e.g. Germany after two years, Italy after six years and Sweden after ten years. Other countries even use an inflation index to adjust the gain, e.g. Belgium,

France and Brazil.¹

3. Ignoring for the moment these economic weaknesses, it might be argued that the inclusion of the capital gains tax in the context of the White Paper would increase equity. This presupposes, however, that the proposals would be as workable as the White Paper authors believe. In our opinion the proposals are in certain respects the reverse of equitable and, more important, in the longer run they are impracticable. In consequence, therefore, changes in the treatment of capital gains will inevitably be introduced on an ad hoc basis and will no longer be designed to fit the integrated White Paper package.
 4. This section of the memorandum seeks to demonstrate the validity of the above criticisms. It is argued hereunder that:
 - (i) the provisions for loss offsets will, unfortunately, have to be modified to the disadvantage of the taxpayer owing to the loss of revenue to which they would give rise.
 - (ii) the proposed treatment of gains from the sale of the principal residence constitutes an unsuccessful attempt to achieve equity in fiscal theory, without in practice, endangering electoral support.
 - (iii) the taxation of accrued gains on widely held assets is discriminatory and will impose hardship on many large stockholders.
 5. As a preliminary to the discussion of the foregoing issues, a quotation from the U.S. Congressional Study Federal Income Tax Treatment of Capital Gains and Losses (June 1951) is particularly apposite. That study observed (p. 22): "Congress has tried time and time again to find a method both practicable and equitable of taxing capital gains. Such a method has been conceived to be one which would interfere as little as possible with the realisation of gains and at the same time would not stimulate loss realisation too much. But finding satisfactory formulae for achieving the
1. Professor R. Clark's contribution Inflation, Taxation and the White Paper to the 1970 Conference of the Canadian Tax Foundation discusses these issues in the light of recent developments and economic writings.

divergent equity and incentive objectives that are entwined in the philosophy of capital gains taxation and at the same time protecting the Revenue has been a difficult problem. Consequently the history of the legal provisions has been a record of compromise and change without satisfactory solution."¹

6. The present complications of the U.S. treatment of capital gains stem less from the actual design of the tax, i.e. the existence of the preferential long-term rate, than from the attitudes of Congress towards taxation. During the past quarter of a century the U.S. Congress has sought to moderate the excessive top rates of income tax by providing, in effect, a whole series of loopholes whereby ordinary income could be converted into capital gains. Once this practice had started - initially perhaps with some justification - it became virtually impossible not to extend the range of such preferences and, at the same time, open up new loopholes for avoidance.
7. In the light of this American post-World War II experience, it is understandable that Professor Conway and the Canadian Government should seek to avoid these complications by avoiding the use of a preferential rate. But, the anomalies and inequities of the present U.S. tax have led them to overlook the earlier and highly relevant experience of the U.S. Government in seeking an equitable basis for taxing capital gains. More to the point, it has led Professor Conway and the Government to assume that they could devise a tax on capital gains which was both equitable and administratively feasible, a task which has certainly defeated the U.S. Treasury and to a certain extent the U.K. Inland Revenue too.²
8. Professor J.A. Pechman, Director of the Brookings Institute, whose views on tax matters are certainly progressive, concedes that "in
 1. The justice of this statement and an interesting exchange of differing views on the basic problems of capital gains taxation are well brought together in The Tax Institute's study - "Capital Gains Taxation: A Panel Discussion".
 2. Conway's study should be read in conjunction with the 1951 Tax Institute Panel discussion to get the basic issues into clearer perspective and, more important, the other side of the arguments.

the quest to reconcile equity and economic objectives with taxation of capital gains, tax experts differ as to the best approach."¹ Any capital gains tax is a compound of equity and administrative convenience. For example, there are a number of areas where equity has, in general, to give way to administrative considerations. The most obvious case concerns the general restriction of the tax to realised, as distinct from accrued, gains. A further problem stems from the decision to tax only realised gains, since a situation then arises in which 'bunched' gains accumulated over many years will, when realised, be charged at the taxpayer's highest rate of tax as income of a single year. Hence special provision is made to avoid this situation, usually by differentiating between 'short' and 'long' term gains. A third problem - and in some respects the most intractable - stems from the need, in equity, for parallel treatment of gains and losses.²

9. The White Paper proposals provide a tax which, at first sight, avoids all these contentious issues. For example, by aggregating gains and losses with ordinary income almost parallel treatment of gains and losses³ seems to be achieved. Second, by treating all gains as ordinary income and not discriminating between gains and losses according to the holding period, i.e., the length of time the asset was held, the incentive to defer taking gains is abolished. A final feature of the White Paper proposal is that attempts by the taxpayer to convert ordinary income into capital gain (chargeable either at a reduced rate or, as at present, tax exempt) are rendered pointless.
10. Thus, by starting ab initio and drawing upon other nations' experience, the Canadian Government has put forward what it believes to be a solution to the difficulties experienced abroad. Either the Canadian Government has succeeded therefore where others have largely failed, or the White Paper proposals relating to capital gains are

1. Federal Tax Policy. The Brookings Institution, p. 92.

2. See, for discussion of this particularly difficult point, Congressional Paper, op.cit., pp. 63-4.

3. 'Almost' because of problem discussed in footnote (2).

unworkable for, in the existing literature, the basic features of the Canadian proposal have all been examined and found wanting.¹

11. Before arguing that it is the latter rather than the former conclusion which is correct, it is pertinent to draw attention to one further aspect of the problem. In the long run the effectiveness of legislation depends on the public's acceptance of the resultant laws. As far as tax laws are concerned, taxpayer compliance is dependent upon a recognition that taxes and rates are 'fair'. What constitutes 'fair' is not decided by Government; it is a reflection of public attitudes. No doubt a highly efficient National Revenue machine can enforce a measure of compliance but, ultimately, it must be government by 'consent', not by 'decree'. As Messrs. Bird and Oldham observe, "a requirement for satisfactory income taxation is a large degree of voluntary compliance on the part of taxpayers".²
12. This consideration is especially relevant to the treatment of capital gains which, as far as the average taxpayer is concerned, nowadays stem primarily from inflation. As a memorandum of the U.K. Inland Revenue put the matter, "if the view were taken that realised capital gains generally speaking possess taxable capacity of the same quality as ordinary income, the most straightforward method of taxing them would be to treat them as additions to the income of the year of realisation."³ But, since the effect of this policy would be to "compress a gain that had accrued over a number of years into one year", the resultant tax liability would be onerous.
13. It has to be recognised that, while the theoretical arguments for treating 'inflation gains' in the same way as any other gains are cogent, the ordinary taxpayer will certainly see the matter

1. See for example the Congressional study, op.cit.; and Seltzer's The Nature and Treatment of Capital Gains and Losses.

2. Op.cit., p. 25. This point is discussed further in para. 31.

3. Royal Commission on the Taxation of Profits and Income. Final Report. Cmnd. 9474.

differently.¹ The U.K. Inland Revenue memorandum observed with admirable prescience that "there can be no doubt that any attempt to impose a wholly new charge on realised gains which have not hitherto been liable, without making some allowance for changes in the general price level would meet with the strongest opposition."² And, as the same paragraph noted, any such treatment would fall with especial severity on those with "relatively small capital possessions".

Much the same point has been made by Professor R.A. Musgrove in his review of the Carter Commission Report where he observed that "an equitable concept of income must be in real terms". The reason for this view is that even a slow price rise over a long period "may result in substantial pseudo-gains".³

14. In economic terms there is no difference between capital gains and ordinary income, as exemplified in the proposals of both the Carter Commission and the Government's White Paper. However, for the reasons outlined in the previous paragraph, capital gains tend to be differentiated in tax systems from ordinary income. Furthermore, in practice, the 'bunching' of realised gains on the disposal of

1. Conway gives a brief summary of these arguments, pp. 6-17. After 5 years with the U.K. tax people still write at length to the newspapers protesting over the taxation of 'illusory' gains. A symptom of this attitude is a significant measure of evasion; i.e. non-disclosure of gains, which the Inland Revenue is seeking to discourage by sample checking of brokers' records.
2. Cmnd. 9474, para. 10. The following may illustrate the point. Two taxpayers with equal income, one of whom is a shrewd speculator in the stock markets and the other who has inherited some assets from a deceased relative many years ago, both realise gains in a given year of \$25,000. The one represents an accumulation of gains derived from a series of Stock Exchange transactions during the past tax year, while the other is the result of selling out assets inherited many years ago at a far lower value. These have appreciated, in part due to inflation, in part perhaps to other factors, to yield a substantial capital gain. It is inconceivable that public opinion would view these two equal sums as meriting similar treatment as proposed in the White Paper; i.e., as additions to ordinary income.
3. The Canadian Journal of Economics. Suppt. No. 1. Feb. 1968, p. 163.

assets held for many years, coupled with inflation and progressive tax rates, makes it necessary, if the tax is to be regarded as equitable, either to make specific provision to meet all cases of hardship or to treat capital gains as a class of income sui generis. Since the former course is impracticable, the only alternative is differential rates for ordinary income and capital gains. "Averaging" does not meet this problem unless the gain is apportioned over the entire holding period but, even then, it still leaves the "inflation" problem unresolved.

15. Given an application of the White Paper proposed top rate of 50 per cent, half the entire capital gain will be absorbed by tax. But, had the gain accrued evenly over the holding period and, if charged at the time it accrued, then the gain would in many cases have attracted lower rates of tax. This follows for two reasons; first the taxpayer would in earlier years probably have had a smaller income and hence his marginal - i.e. top-rate-of tax would be lower than 50%; second, the absence of bunching would avoid a large part of the gain coming into the highest tax bracket. Even if the proposed Canadian tax rates are regarded as 'reasonable' and are appropriate to the proposed treatment of capital gains, the fact is that the realisation basis coupled with the top rate of marginal income in the year of realisation will impose a much heavier burden than if the accruals basis were practicable.
16. The argument that progressive tax rates impose an intolerable burden on "bunched" capital gains realised in the year of assessment is only partially countered in the White Paper scheme by applying a maximum rate of tax equal to 50 per cent. By comparison with the corresponding top rates of tax on ordinary income in the U.S.A. and the U.K. such a rate seems eminently reasonable, until it is borne in mind that no one pays these rates on his capital gains! In the U.S.A. the current maximum rate is 25 on gains after 6 months holding period and in the U.K. 30 per cent after 12 months holding.
17. The alternative to a realisation basis; i.e. the accrual basis - however persuasive and logical it may be in theory, is incompatible

with modern tax practice. On this issue Professor R.A. Musgrave has commented that "while it seems impossible to justify the requirement that income must be realised before it is taxed, a defense of the realisation rule may be made in pragmatic terms. It is the function of accounting rules to result in business statements that are as reliable and meaningful as possible in their practical application. Since valuation without sale is a difficult matter, the inclusion of unrealised gains may involve a high degree of arbitrariness.¹ The distortions which arise from faulty valuation may be worse than those which result if only realised gains are taken into account."²

18. Assessment to income tax of individuals is normally based on the actual income received. In the case of corporations it is fundamental that the basis of charging excludes unrealised profits.³ Why then should a particular part of a taxpayer's assets be taxed differently from ordinary income or corporate profits? The Inland Revenue Memorandum noted that "since much paper appreciation tends to disappear subsequently there might well be a formidable amount of unremunerative work in assessing and collecting tax that had to be repaid later" (para. 12). Hence it follows that on grounds of both principle and administration the taxation of accrued gains can be strongly criticised.
19. Even if the top rates of income tax are limited to 50 per cent, a prospect which is by no means certain,⁴ to treat bunched gains as the income of a single year can often cause serious hardship. What does, however, destroy the case for full inclusion of capital gains are the consequences of the need - on grounds of equity - for parallel treatment of losses. The White Paper proposes as a quid
 1. If it be argued that widely held corporate stock can be valued, the proposed White Paper scheme on this point is still inequitable. Values may change quickly and result in two taxpayers with different dates for valuation charged quite different sums in tax.
 2. The Theory of Public Finance, pp. 166-67.
 3. See, for example, An Introduction to Corporate Accounting Standards, American Accounting Association, by W. Paton and A. Littleton, pp. 48-49.
 4. For reasons given in Part A, No. 1, page 11, para. 8.

pro quo for full inclusion of gains, that losses shall also be aggregated with ordinary income. In other words, capital losses will reduce that part of the taxpayer's income chargeable at his highest rate of tax.

20. American experience has shown that such loss offsets are unworkable since they can seriously affect the revenues from income tax. During 1931 U.S. law gave unrestricted offsets against ordinary income for short-term losses and $12\frac{1}{2}$ per cent of long-term losses. The Congressional paper (op.cit. p. 62) notes that "due to the precipitous decline in security prices in that year, the net direct revenue loss attributable to net capital losses of individuals is estimated to have reduced the yield from the personal income tax from \$355 m. to \$246 m." That net loss of \$89 m. represented some 27 per cent of the then gross yield of the personal income tax. It was this experience which led Congress in the following year to restrict severely the net loss offset against ordinary income. In its Report on the Revenue Bill of 1932, the Committee on Ways and Means noted that "many taxpayers have been completely or partially eliminating from tax their income from salaries, dividends, rents, etc. by deducting therefrom losses sustained in the stock and bond markets with serious effects upon the Revenue. Your Committee is of the opinion that some limitation ought to be placed on the allowance of such losses."¹ Not surprisingly, in the light of this experience, the Congressional study observes (p. 62) "the belief that Federal tax revenue should be protected in the event of a severe price decline is the principal basis for the loss limitation provisions of the existing law."
21. This consideration clearly weighed heavily with the Minority of the U.K. Royal Commission on the Taxation of Profits and Income. They noted that, since the taxpayer is able to arrange to take his losses to obtain maximum tax advantage, then "if capital losses were deductible from ordinary income, it would on occasions be possible to realise losses (with no corresponding diminution in ordinary income) merely to obtain tax relief" (para. 13). The Minority went

1. House of Representatives Paper No. 708, 72nd Congress, p. 12.

on to add to their strictures on the subject of loss offsets that even the carrying back of losses should be prohibited. One unfortunate result of such limitation on loss offsets is that it discriminates against the less well-off since, in the words of the Congressional study, "it is primarily the lower and middle income taxpayers who require income offset to recover the tax value of their capital losses."

22. Against such reservations regarding loss offsets it may be argued that, with inflation a continuing fact of life in all modern economies, the dangers of sharp falls in asset values upon tax revenues can be exaggerated. This is no doubt true. We are, let us hope, not likely to experience another Wall Street crash similar to that of 1931, or the ensuing depression. Nevertheless, stock markets, even within extended periods of inflation, can experience quite sharp reverses; witness the experience of both London and Wall Street in 1969. The current severe restrictions on net loss offsets in both the U.S.A. and the U.K. avoid the danger of losses cutting into the revenue from the income tax. Under the White Paper proposals, however, the impact of a slump in security values on income tax revenues could be severe. Yet it is precisely to this tax that the Government is looking to replace revenue foregone by concessions proposed in the White Paper.
23. The significance of this particular criticism of the White Paper scheme for taxing capital gains is as self-evident as it is fundamental. Once it is recognised that net losses cannot be relieved in full against ordinary income, the need in equity for parallel treatment of gains and losses means that any restriction in loss offsets must be matched by a corresponding abatement in the charge imposed on capital gains.
24. Given the proposed scheme then, there will be a danger that future events will impel the Government to limit the opportunities of unrestricted loss affects. But, would the Government - to preserve equity - at the same time abate correspondingly the rate of tax on gains? One can just imagine a future Minister of Finance explaining to Parliament and the electorate that, because speculators have been

avoiding tax by taking "paper" losses (i.e. selling and buying back depreciated assets at about the same price to obtain a realized "loss"), it had become necessary to recast the tax on capital gains, as a result of which gains would be less heavily taxed than before!

25. In paragraph 4, above, a criticism was made of the White Paper's capital gains tax scheme as it applied to the sale of private homes. Those proposals illustrate the justice of the assertion that attempting to combine fiscal equity and political pragmatism is, in the case of capital gains taxation, an attempt to reconcile the irreconcilable.
26. The case for taxing such gains on the score of equity is that to exclude the gains (and losses) from one particular type of asset is to discriminate against all other classes of asset. But the difficulties which the White Paper proposals do not admit are exemplified by the exemption of such gains in the U.S. and U.K. First, there is the "inflation argument" which is more clearly brought out in connection with the taxpayer's residence than in the case of any other asset. This practice of exempting any gain on the taxpayer's home is justified on the grounds that people must have a home and that the sale of a house is normally immediately followed by a purchase. In other words, the sale is not usually motivated by a desire for profit. There are also other reasons for such exemptions. If the gain on the sale of a taxpayer's residence is taxed then, due to the rise in prices in most parts of Canada (which arises from a combination of inflation and pressure of demand from a growing urban population) the taxpayer would certainly find the net proceeds insufficient to purchase another comparable residence in the same area. In other words, given any inflation element in the gain, the capital gains tax is revealed as a tax on capital; it is clearly not an accretion to income.
27. In making this point it is not denied that the home-owner may by virtue of home-ownership be better-off, i.e. possesses a greater taxable capacity, than the taxpayer with the same income but living in a rented apartment. There may thus be a case for heavier taxation of the home-owner, but any such tax should be described for what it is, i.e. a tax on wealth.

28. The proposal in the White Paper that the home-owner shall be taxed on his 'gain' only when it exceeds the product of \$1,000 times the number of years of occupancy, is merely a device to 'cover up' the basic point regarding capital taxes made above. The declared object of this proposal - coupled with the proposed exemption of the gain when the taxpayer moves from one region to another in connection with a change of job is that "generally capital gains on the sale of homes would not be taxed".¹
29. This particular proposal merits two criticisms.² The first is that it does not achieve the degree of equity that a blanket exemption of gains from sales of principal residences would achieve. It is based on the assumption that residences across the breadth of Canada have all experienced the same degree, not in relative terms, but in absolute terms, of price appreciation during a given period. This is nonsense. The fact is that residences in different parts of Canada, even within the same city, have appreciated - and even depreciated - in widely differing degrees in quite a short period of years. And, on a related point, since the present proposal obviously discriminates against the wealthier taxpayer, because a \$1,000 p.a. appreciation is supposed to exempt the gain only on the 'average' house, why does the Government not say so?
30. Second, on what grounds can an annual exemption of \$1,000 of gain be justified in respect of occupation of a residence, as distinct from any other class of asset? Why - given the emphasis in the White Paper on equity - should the owner of a residence get his capital gain virtually tax-free, while the taxpayer opting to live in rented apartment sells his stock-holdings (purchased in lieu of a residence) and then must pay tax on his gain? In a minority of cases, where the occupancy was of relatively short duration, it might be claimed by
1. The "roll-over" provision is also unfair, given the requirement to move some distance. In other words, exemption is granted only when there is "forced disposal". (Paragraph 3.19).
2. This proposal merits particular criticism by people owning homes in Vancouver. See Part B, No. 4.

the taxpayer, that he had spent on improvements a sum equivalent to \$1,000 p.a. and thus the capital gain was non-existent. But this is an entirely different argument from that on which the White Paper proposal is based. The proof of this is evidenced by the provision of a further allowance of \$150 p.a., or actual expenditure, in respect of improvements to be allowed in determining the basic 'cost' of the residence.

31. The conflict of equity and administration inherent in capital gains taxation is also illustrated by the proposals for taxing gains from the disposal of 'other property held for personal use or enjoyment'. The authors of the White Paper recognise that exemptions have to be made in respect of assets the proceeds of which do not exceed \$500. This is proposed not, let it be faced, because Canadians cannot be turned into a 'nation of book-keepers', but for the simple fact that the probable scale of evasion would make a mockery of the tax.¹ But, even the \$500 limit is likely to be evaded, either by non-disclosure or by selling in lots by cheque for \$500 and taking the balance of the proceeds in cash.
 32. There is the wider issue of principle that such an exemption - however limited - offers immediate opportunities for avoidance. It is not long before the shrewder and less honest taxpayers exploit such concessions to limit their tax liability. The ordinary honest taxpayer soon becomes aware of the fact and, once this happens, then the equity of the capital gains tax is destroyed. Furthermore, such a situation hits a taxpayer morale and affects taxpayer compliance.
 33. It is common knowledge that many more people in the U.K. are now investing in stamp collections, objects d'art, gold and silver medallions, old books and prints. The quality newspapers and journals even discuss their attractions as inflation 'hedges', if not as tax 'loopholes'. In most cases collections can be built up discreetly and without large outgoings. The owners regard the assets
1. One needs only to consider the problem of 'marginal relief', in respect of sales slightly in excess of the above limit to realise the inequities involved.

as an inflation hedge and, when the time comes to sell - assuming it is in the lifetime of the owner - one can be certain that neither the disposal of such valuables will be publicised nor the Inland Revenue informed of the resultant gain. The White Paper proposals to bring into charge the large number of 'capital' transactions in which the basic cost of the asset exceeds a mere \$500 will necessitate a high degree of taxpayer supervision by the National Revenue.

To be brutally frank, it is this sort of provision and others in the White Paper which reflect a degree of 'unworldliness' and obsession with theory which is impracticable, that makes the reader question the logic and validity of much of the entire exercise in tax 'reform'. To be effective, such provisions will need to be coupled with the assistance - legally enforced - of brokers, dealers and agents. Even informers (from which source the U.K. Inland Revenue derives a lot of its information which enables them to pick up cases of fraud) will prove useful. Such an outcome will not be acceptable to Canadian public opinion, yet it is inevitable if the equity of the gains tax is not to be visibly destroyed.¹

34. Perhaps the most striking illustration of an arbitrary solution of the inherent conflict between equity and administrative considerations is provided by the White Paper proposals relating to shares in widely held Canadian companies. On this class of asset, capital gains tax will be charged not on the realised gain, but on the accrued gain at quinquennial intervals. The case against charging accrued, i.e. non-realised, gains has already been criticised as contrary to the principle that only realised profits and income shall be taxed.²
35. The issue is, however, quite simple. If the taxation of accrued gains is valid on grounds of equity, then it should apply to all other accrued gains. The proposal to charge accrued, i.e. non-realised, gains only on widely held shares is not equitable. It is not even justified on that score in the White Paper, although it

1. The taxation of gains from personal possessions is examined again in Part B, No. 5.

2. Paras. 21-3. Also discussed in Part B, No. 3.

can be argued in theory that taxing accrued gains provides a more equitable basis than realised gains.¹

The reason why it has not hitherto been adopted elsewhere in practice is that it creates considerable problems of administration and, more important, hardship for the taxpayer. The latter will have to find the liquid resources to meet the charge on a gain he may never receive. The White Paper suggestion that the valuations be made at quinquennial intervals in accordance with the taxpayer's age in multiples of five is merely a device to meet partially the administrative complications of this proposal. It does not, however, affect the basic injustice of the proposal; it may in fact exacerbate the inequity by virtue of random price movements in the year.

36. There are obvious reasons why this particular proposal is unjust. It discriminates against one particular class of assets. It is not a satisfactory answer to assert that any inequity is alleviated because the holders of these assets are charged on only 50 per cent of the net gain. That particular measure in itself involves a measure of discrimination, i.e. inequity as against other types of asset.² In short, two inequities do not constitute fiscal justice; they remain what they are - ad hoc measures designed to collect revenue at intervals dictated by the Government rather than the taxpayer, regardless of the possible hardship the proposal may generate.
 37. The avowed justification for this inequity, as set out in the White Paper, is that "periodic revaluation would reduce the 'lock-in' effect that might well otherwise occur" (para. 3.37). The significance of this admission should not be overlooked. The entire thesis of the White Paper proposals is that while they will achieve some redistribution of the tax burden between Canadian taxpayers, the various tax measures "are expected to have relatively modest impacts
1. This point is developed in the U.S. Congressional Study, in the U.K. Inland Revenue memorandum to the Royal Commission and in the Conway study.
 2. The illogicality of the proposal on the score of equity is obvious since the White Paper is in effect asserting that 50 per cent tax on a realised gain is equivalent to 50 x 50 per cent - 25 per cent on an unrealised gain.

upon the economy" (para. 8.35), i.e. side effects on business or investment behaviour. Yet, the White Paper contends that periodic assessment is necessary to avoid any 'locked-in' effect. The authors of the White Paper would seem to want to have it both ways!

The White Paper conclusion relating to the impact of these proposals is particularly surprising in the light of the figures forwarded in Table 15 B-2 of the Minister of Finance paper to the Commons and Senate Committees studying the White Paper.¹ For example, the additional tax paid by the \$25 - 50,000 income bracket in the fifth year is estimated at \$34.6 m. Of that sum \$15.5 m. will come from deemed realisation of gains on widely held company shares. In the \$50 - 100,000 bracket, the ratio is even higher, \$9.5 m. out of \$14.8 and in the highest income brackets the revenue from this charge accounts for more than the total net contribution of this income bracket to the Revenue. Given the magnitude of these figures and bearing in mind the further estimated \$43.5 m. to be collected from the \$25 - 50,000 income bracket in respect of realised capital gains and \$30.9 m. for the \$50 - 100,000 bracket, it is unlikely that taxpayers in these brackets will be quite so indifferent to this particular "reform" as the White Paper implies.

1. Letter dated March 6, 1970 (70-28).

PART B

C O N T E N T S

of

Commentaries and studies relating to specific areas
of the White Paper

1. Liaison with Provincial Governments.
2. Comparison of the weight of taxation suffered by individuals and corporations residing in Canada compared with the weight of taxation suffered by comparable entities in the United States.
3. Proposal for periodic valuation of shares in widely-held Canadian companies.
4. Proposal for the taxation of gains derived from the sale of private homes.
5. Proposal for taxation of gains made from the sales of personal possessions.
6. Deemed realisation of market value of assets of persons ceasing to be resident in Canada.
7. Deemed realisation upon gifting of assets.
8. Valuation of assets as of "Valuation Day".
9. Elimination of low rate of corporate tax.
10. Proposal that corporations distribute earnings within $2\frac{1}{2}$ years in order to preserve creditable tax.
11. Transitional restriction of creditable tax.
12. Denial of deduction for entertainment and related expenses.
13. Income averaging.
14. Taxation of mining and oil industries.
15. Taxation of international transactions.

VANCOUVER BOARD OF TRADE

Commentaries and studies relating to
the Canadian White Paper on Proposals for Tax Reform

No. 1 : Liaison with the Provincial Governments

LIAISON WITH THE PROVINCIAL GOVERNMENTS

Table 1 of the February 1970 Report of the Tax Structure Committee to the Federal-Provincial Conference of Prime Ministers and Premiers indicates that the combined expenditures of Provincial and Municipal governments during the current fiscal year will, for the first time, exceed federal government expenditure by more than \$1 billion. The same table shows that the combined Provincial and Municipal expenditures when expressed as a percentage of federal expenditures will have escalated by 1972 to a figure of approximately 120% compared with a figure of approximately 50% in 1952.

Table 2 of the same report suggests that by 1971, Provincial and Municipal expenditures will exceed revenues projected from current bases by over \$2 billion.

These statistics are cause for a great deal of concern and, as the report suggests, very careful analyses must be prepared of projected expenditures. The figures also make crystal clear that close co-ordination and co-operation between federal, provincial and municipal governments with respect to the overall tax gathering structure of the country is absolutely imperative if a stable and healthy economy is to be attained.

With this thought in mind, it is with concern that one considers the complex shifts in the regional incidence of income taxes which an implementation of the White Paper proposals would likely bring about. The effects of integrating corporate tax with the tax liabilities of the corporations' shareholders would, alone, bring about different patterns of tax burdens. For instance, an Ontario corporation may pay a corporate income tax - 12 percentage points of which will accrue to the government of Ontario - but many of its shareholders may reside in other provinces. To the extent that the integration proposals require tax refunds to be paid to such shareholders, the revenues of the other provinces from personal income taxes would presumably be reduced.

Other abstruse shifts in revenues might result from variations between Provinces of the composition of the total corporate population as between closely-held and widely-held companies. It must be remembered also that the provincial personal income tax rates would be applied on a different base under the White Paper proposals than under the present system.

The Vancouver Board of Trade would suggest, therefore, that the government be asked to make known the detailed basis underlying the estimates of

Provincial revenues under the White Paper proposals as set out in Tables 13 and 14 of the White Paper and Supplementary¹ Tables 13A, 14A, 15A-1 and 15A-2. If such details were known, it might be possible to determine with more realism the extent to which any particular province might have to depend on the guarantee² set out by the federal government in paragraph 7.26 of the White Paper. It might also be possible to determine with greater accuracy what the provinces' position might be after such a guarantee had lapsed.

1. As filed by the Minister of Finance with the House of Commons Committee on Finance, Trade & Economic Affairs on February 5, 1970.
2. Under paragraph 7.26, the White Paper offers to guarantee provincial revenues against unforeseen reductions in the aggregate yield of the revised personal and corporate income taxes for a period of several years.

VANCOUVER BOARD OF TRADE

Commentaries and studies relating to
the Canadian White Paper on Proposals for Tax Reform

No. 2 : Comparison of the weight of taxation suffered
by individuals and corporations residing in
Canada with the weight of taxation suffered
by equivalent entities in the United States.

COMPARISON OF THE WEIGHT OF TAXATION SUFFERED BY
INDIVIDUALS AND CORPORATIONS RESIDING IN CANADA
COMPARED WITH THE WEIGHT OF TAXATION SUFFERED BY
COMPARABLE ENTITIES IN THE UNITED STATES

Because of the tremendous influence of the United States upon the economic and sociological aspects of Canadian life, it is natural to wish to compare the weight of income taxation in both countries. The Canadian government too, acknowledges that such a comparison is of significant interest, and reference is made to United States corporate tax rates in paragraph 4.35 of the White Paper and a more detailed comparison of the relative income tax burdens of Canadian and United States individuals is contained in the news release entitled "White Paper Highlights" which was issued by the Department of Finance concurrently with the release of the White Paper.

With respect to the reference in paragraph 4.35 of the White Paper to United States corporate tax rate of 52.8%, this is somewhat misleading in that the 52.8% rate reflects a 10% surcharge which is to be withdrawn before the end of 1971. Following its withdrawal, U.S. corporate rates of tax will be 22% on the first \$25,000 of taxable income and 48% thereafter.

With respect to a comparison of individual tax rates in the two countries, an independent study prepared by a major firm of chartered accountants, has tackled the very difficult problem of making a meaningful comparison by showing a variety of examples in respect of which all factors relevant to the making of an objective comparison have been carefully stated and utilized. These examples show conclusively that the weight of United States taxation after the recent tax reform programme in that country is very significantly less than the weight of Canadian taxation on individuals which would accrue under the White Paper system.

A copy of the study is attached as the Appendix to these comments with the permission of the firm of chartered accountants.

APPENDIX TO PART B - Study No. 2

A COMPARISON OF CANADIAN AND UNITED STATES
PERSONAL INCOME TAX BURDENS

How Much More Income Taxes Do Canadians Really Pay?

The question of whether Canadian taxpayers pay more personal taxes than taxpayers in the United States, and if so, how much, has often been discussed in this country. The release of the Canadian government's White Paper on tax reform proposals on November 7, 1969 and the enactment of the United States Tax Reform Bill on December 30, 1969 have made this question of more immediate concern, and have aroused renewed interest in the extent to which the Canadian taxpayer pays a larger amount of personal income taxes than his United States counterpart earning the same income.

The Canadian government has recognized that a comparison of the personal income tax burdens of Canadian and United States taxpayers is of some relevance to Canadian tax reform. The news release entitled "White Paper Highlights", which was issued by the Department of Finance concurrently with the release of the White Paper contains a section devoted to a tabular comparison of the relative income tax burdens of Canadian and United States individuals at various income levels. Furthermore, the White Paper itself, (at paragraph number 2-39), states that "Canada needs the full effort of those with outstanding ability. It must compete for such people with other countries where able Canadians can go to live and to work if they wish."

This last statement would seem to be an acknowledgement of the fact that a comparison of the Canadian personal tax burden with that of other foreign countries is one of the many factors which must be considered in the process of tax reform. A materially unfavourable comparison might be a factor both in inducing talented Canadians to leave Canada, taking with them their abilities and their capital, and conversely, inhibiting the immigration of skilled newcomers from other countries into Canada. The United States is the logical country with which to make such a tax comparison, because of its proximity to Canada, its similar standard of living, and the general facility of movement across its borders.

One of the tables presented in the White Paper Highlights released by the Department of Finance sets out the following comparison of the personal tax

liability of a married taxpayer, with two dependent children under the age of 16, living in Ontario, Canada with that of his United States counterpart living in the state of New York:

<u>Total Income</u>	<u>WHITE PAPER COMPARISON</u>		<u>TABLE 1</u>	
	<u>Canadian Income Tax Under White Paper (Ontario)</u>	<u>U.S. Income Tax Before Reform (New York)</u>	<u>U.S. Tax Lower (higher) than Canadian tax</u>	
			<u>Amount</u>	<u>%*</u>
\$ 8,000	\$ 1,260	\$ 1,351	\$ (91)	(7.22)
12,000	2,546	2,369	177	6.95
15,000	3,625	3,236	389	10.73
25,000	7,867	6,697	1,170	14.87
50,000	20,192	18,809	1,383	6.85

* As a % of Canadian income tax (in all tables)

The \$25,000 income bracket was not included in the government table, but has been calculated on the same basis as that used for the other income levels.

In calculating the above comparison, the Department of Finance assumed that the taxpayer derived his entire income from employment, and that none of his dependents received any income of their own. Canada Pension Plan contributions (\$83.) and U.S. Social Security Contributions (\$374.) were included in the respective totals of Canadian and United States income taxes. No account was taken by the Department of the difference in the value of the Canadian and United States dollar. Other assumptions underlying the government's calculations are set out in Appendix A/1 attached.

The government's tables compare the tax burdens on gross incomes ranging from \$1,000 to \$100,000, while this study has been restricted to a comparison of the relative Canadian and United States tax burdens of individuals earning from \$8,000 to \$50,000. We feel that this range of middle and upper incomes is generally representative of the earnings of a group of relatively skilled workers, such as craftsmen and technicians, foremen, professionals (including doctors, lawyers, engineers and scientists), teachers and educators, and business executives. These taxpayers, as a group, are particularly valuable to Canada because of their training and skills. Furthermore, the demand for the services of such individuals frequently presses upon the available supply, and their talents are normally freely transferable from one country to the other. Accordingly, this group of taxpayers, deriving all of their income

from their personal endeavours, appears to us to be particularly sensitive to differentials in Canadian and United States personal tax rates.

The personal tax comparisons presented in the White Paper Highlights seem to indicate that the personal income tax burden of a Canadian is not substantially in excess of that of his United States counterpart at the same income level, particularly in the lower and upper income brackets, and hence the differential between United States and Canadian personal taxes might be assumed to be an insignificant factor in personnel movements between the two countries. However, our firm has often made a comparison of the burden of Canadian and U.S. personal taxes for clients, based on the actual situation of a particular employee who has been transferred between the two countries, and we have usually found the differential to be substantial. Our review of the basis of the calculations employed in the White Paper Highlights has indicated that the reason that this significant difference is not reflected in the comparative tables produced in the Highlights is because of the choice of what we regard as inappropriate assumptions relating to the calculation of United States and Canadian taxes.

We feel that the comparison in the White Paper Highlights may be inappropriate for a number of reasons. For one thing, we doubt that any single comparison of the tax position of United States wage earners with their Canadian counterparts can be as informative as a series of such comparisons, based on the varying situations in which individual taxpayers may be found. Furthermore, we feel that certain basic assumptions used in the government's comparison, such as the omission of an allowance for the difference in value of Canadian and United States dollars, the inclusion of social security taxes in the quoted income tax figures, and inadequate allowances for deductions have tended to produce an unreasonably low differential between Canadian and United States taxes in the White Paper analysis.

It should be realized that there are a wide variety of methods which are available to anyone who wishes to make a comparison of Canadian and United States personal income taxes, and a wide variety of criteria and assumptions which may be followed in arriving at the tax figures for use in such a comparison. This is particularly true in the calculation of the United States income tax, since the United States taxpayer has the advantage of a much broader range of deductible expenses in computing his taxable income;

there are also large differences in the rates of personal taxation at the state level.

In the following study, we have set out a comparison of Canadian and United States personal income taxes which, in our opinion, is more closely aligned to the actual position of the taxpayers in each country.

A Comparison of Average Taxpayers:

Unlike the comparison issued by the Department of Finance, the table below shows that income taxes at all income levels from \$8,000 to \$50,000 are significantly lower in the United States than in Canada. The reasons for the substantial difference between the calculation made by the Department of Finance and our comparison relate to certain differences in basic assumptions and methods used in the calculation of the relative Canadian and United States income taxes. For one thing, in our calculations we have included neither Canada Pension Plan contributions (\$83) nor U.S. Social Security contributions (U.S. \$374) in the respective Canadian and United States income tax totals. We have excluded these contributions on the grounds that social security levies are not income taxes as such, since such amounts are related, at least in part, to benefits which may be provided to the individual under the respective social security systems of Canada and the United States. We do not feel it appropriate to include such social security payments in the computation of direct tax liabilities without giving some weight to the respective benefits which are provided by the two programs: While it is clear that United States social security benefits are substantially more favourable than their Canadian counterparts (especially since such payments are exempt from U.S. personal income taxes), we were unable to arrive at any quantitative measure of this difference and hence omitted the levies and the related benefits from our comparisons.

Furthermore, in our calculations we have made an allowance for the difference in the value of the Canadian and United States dollar. For instance, the total tax payable by a Canadian earning - say - \$15,000 has been compared to the United States tax (stated in Canadian dollars) payable by a United States taxpayer earning \$13,950 in U.S. currency, which is the equivalent, at current exchange rates, of \$15,000 Canadian. The government's calculations ignored this exchange differential but we feel that the differing

values of the Canadian and United States dollars should be taken into account in any comparison of respective tax burdens, just as would be the case if the comparison was being made with taxpayers in other countries.

Finally, in our calculations of the taxable income of our hypothetical Canadian and United States taxpayers, we have used average deductions from income as determined from statistical summaries published by the Canadian and United States governments. These statistics indicate the average deductions from income claimed by Canadian and United States taxpayers in the 1967 taxation year (the latest year for which statistics are available) were substantially in excess of the percentage allowances used by the government in its calculations, particularly in the case of U.S. taxpayers (who may deduct all interest payments, including home mortgage, and property taxes as well as charitable contributions and medical expenses in calculating their taxable income). The United States statistics reveal that the average United States taxpayer who itemized his deductions in 1967 claimed total deductions from income (exclusive of state income taxes) equal to from 8% (at the \$50,000 income level) to 17% (at the \$8,000 income level) of his total income; the corresponding allowance for deductions used by the government in its calculations amount to only 5% of total income for United States taxpayers with incomes in excess of \$12,000. Since some 77% of all United States taxpayers with incomes of \$10,000 and above itemized their deductions in recent years we feel that it is only appropriate to use the actual statistical averages of these deductions in the computation of the taxable income and average taxes payable by United States residents for the purpose of comparing them with Canadian residents.

A detailed description of the source of the statistical data used and the method of calculation of average deductions for Canadian and United States tax purposes is set out in Appendix A/3; it will be noted that our assumptions involved a degree of interpolation and estimation for some of the income levels and hence the related calculations cannot be regarded as entirely precise.

We feel that the following table represents a more realistic comparison of the personal income tax payable by a Canadian resident in Ontario, as computed under the White Paper proposals, with the personal income tax payable by a United States taxpayer resident in New York state, as computed

under rates in effect for the 1969 taxation year (and before giving effect to the changes enacted in the United States Tax Reform Bill of 1969):

Total Income	A COMPARISON BEFORE UNITED STATES TAX REFORM		TABLE II	
	Canadian Income Tax Under White Paper (Ontario)	U.S. Income Tax 1969 Rates (New York)	U.S. Tax Lower than Canadian Tax	
			Amount	%
\$ 8,000	\$ 1,044	\$ 730	\$ 314	30.08
12,000	2,327	1,600	727	31.24
15,000	3,370	2,355	1,015	30.12
25,000	7,434	5,351	2,083	28.02
50,000	19,631	16,590	3,041	15.49

As in Table I, this comparison is based on the position of a married taxpayer, with two children under 16, who derives his entire income from wages or salaries. As noted above, Canada Pension Plan contributions and U.S. Social Security levies have not been included in the income tax totals. Allowance has been made for the difference in value of the Canadian and United States dollar in the computation of the comparative tax burdens. We have also assumed that both the United States and Canadian taxpayer have claimed deductions for charitable donations, medical expenses, and other allowances based on the average deductions claimed by such taxpayers in the various income brackets as shown by government statistical summaries. A detailed summary of the assumptions and criteria used in the computations are set out in Appendix A/2. All tables following this table are also based on these assumptions except as specifically noted.

United States Tax Reform:

President Richard Nixon has recently signed into law a tax reform bill which will result in substantial tax reductions for most individual United States taxpayers: These changes will be phased in over the 1970 to 1973 taxation years, and will be fully in effect for the 1973 taxation year. Since the computation of Canadian income tax, as set out in Table II, has been based upon the White Paper proposals as they would apply at the end of the phasing-in period (likely after 1974), it would seem reasonable to give effect to the United States Tax Reform Bill amendments, after full phasing-in in 1973, in the computation of the comparable United States income tax.

(The United States Reform Bill was not signed into law until December 30, 1969 and hence the government had no opportunity of reflecting its provisions in the United States tax computations used in its White Paper comparison of November 7, 1969.)

If the U.S. federal tax computation, as shown on Table II, is amended to reflect such recent United States tax changes as the increase in personal exemptions to \$750 each, an increase in the standard deduction (where applicable) to 15% or \$2,000, and the deletion of the 10% surtax, the following comparison of the personal income tax burden of a married Canadian taxpayer, resident in Ontario, with that of his United States counterpart, resident in the state of New York, will emerge:

<u>Total Income</u>	<u>A COMPARISON OF AVERAGE TAXPAYERS</u>		<u>TABLE III</u>	
	<u>Canadian Income Tax Under White Paper (Ontario)</u>	<u>U.S. Income Tax After Reform (New York)</u>	<u>U.S. Tax Lower than Canadian Tax</u>	
			<u>Amount</u>	<u>%</u>
\$ 8,000	\$ 1,044	\$ 569	\$ 475	45.50
12,000	2,327	1,353	974	41.86
15,000	3,370	2,036	1,334	39.58
25,000	7,434	4,791	2,643	35.55
50,000	19,631	15,202	4,429	22.56

Table II was presented previously as a reasonable comparison of the Canadian and United States tax burdens of married taxpayers before taking into account the United States Tax Reform Bill. However, since this bill has now been enacted, we feel that Table III represents an appropriate current comparison of the future personal income tax burdens of average married Canadian taxpayers resident in Ontario (assuming implementation of the White Paper in its proposed form) and that of their United States counterparts resident in New York state, after the U.S. tax reform amendments recently enacted become fully effective. In all the following tables, the United States federal tax calculations reflect the Tax Reform Bill amendments, after full implementation in 1973.

The comparisons between United States and Canadian personal tax burdens shown in Tables II and III above indicate that the gap between United States and Canadian taxes has been widened significantly as the result of the tax reductions recently enacted in the United States. Of course, the

implementation of the White Paper proposals (reflected in all Canadian tax rates in this bulletin) will in itself contribute to this widening, since the White Paper recommends that the tax burdens of Canadians in middle income brackets, especially those earning between \$10,000 and \$20,000 a year, be increased (by as much as \$200 for the married taxpayer in the \$15,000 income bracket). It should of course be recognized that neither the White Paper tax proposals on the one hand (involving increases in the taxes paid by middle and upper bracket Canadian taxpayers) nor the United States tax reform proposals on the other hand (involving tax cuts for most U.S. taxpayers) are entirely responsible for the large differences between U.S. and Canadian personal taxes noted above; a substantial part of this difference has existed for years.

A comparison of Table III with a table drawn up on the basis of 1969 Canadian (before White Paper) and United States (before reform) tax rates would reveal that the combined effect of the White Paper and the United States Tax Reform Bill will widen the "gap" between U.S. and Canadian taxes from 6 to 15 percentage points in the \$8,000 to \$50,000 income brackets, with the largest increases occurring in the \$10,000 to \$20,000 income brackets.

Tax Position of the Single Taxpayer:

A significant part, but not all, of the difference between United States and Canadian tax burdens shown in the preceding tables is due to the substantial advantage available to married United States taxpayers of being allowed to "split" their incomes for tax purposes with their wives. For example, a married man with income of \$10,000 per year is allowed to calculate his tax liability as though he and his wife had earned \$5,000 each. This privilege, which is not available to Canadian taxpayers, results in a significant reduction in income taxes payable by married taxpayers. A comparison prepared on essentially the same assumptions as those used in the preceding comparison in Table III, but based on a single taxpayer with no dependents, would indicate the following:

<u>Gross Income</u>	<u>U.S. Tax Lower</u>
\$ 8,000	29.66%
12,000	28.88
15,000	27.07
25,000	23.28
50,000	9.92

Hence, the income splitting provisions of the United States Internal Revenue Code provide material benefits for married taxpayers, and a Canadian-United States personal income tax comparison based on single taxpayers would yield smaller differentials.

Interestingly enough, the combined effect of the White Paper proposals and the United States tax reform bill (which in effect provides partial benefits of income splitting to single taxpayers) is far more significant in the case of single taxpayers than of married taxpayers. The gap between Canadian and United States personal income taxes payable by single taxpayers will be widened by these two measures from 14 to 20 percentage points in the \$8,000 to \$50,000 income brackets. For example, a single Canadian taxpayer (resident in Ontario) would pay only 3% more income tax than his United States counterpart (resident in New York) at 1969 rates before the White Paper and United States tax reform, but would pay 23% more tax after full implementation of these measures. This fact may be of some significance, since single taxpayers presumably have more mobility than the married man, and hence may be more susceptible to the lure of lower taxation in the United States.

As the majority of taxpayers in the \$8,000 to \$50,000 income brackets are married, however, our further comparisons in this study are based on married taxpayers as being more representative of the situation of the average Canadian and United States individual.

Taxpayer's Province or State of Residence:

Up to this point, our comparisons have been based on an Ontario resident and a New York state resident, and provincial and state income taxes have been included in the corresponding Canadian and United States tax burdens. However, it should be ascertained whether New York state and Ontario provincial tax burdens are representative of the state and provincial taxes borne by the "average" United States and Canadian taxpayer, respectively.

The state of New York imposes one of the highest rates of personal income tax of the forty states that levy personal taxes (the remaining states impose no personal income taxes), and hence the total U.S. tax shown on the previous table (which includes New York state tax) will be higher than the total U.S. tax incurred by the "average" United States taxpayer, since this average taxpayer will pay less state income tax. However, no specific statistics are

available in respect of the average amount of state tax incurred by the "average" United States taxpayer, and hence it is difficult to strike a balance in this regard. As an alternative, it is suggested that a comparison might be made, on the same basis as in Table III above, assuming that the United States taxpayer is resident in the state of Ohio, which imposes no personal income taxes; since it is known that New York imposes none, a comparison with an "average" United States taxpayer will fall somewhere between the two positions. A comparison of the tax burden of a married Canadian resident in Ontario with that of his United States counterpart resident in Ohio, based on assumptions as previously set out, is as follows:

<u>Total Income</u>	<u>CHOICE OF STATE OF RESIDENCE OF U.S. TAXPAYER</u>		<u>TABLE IV</u>	
	Canadian Income Tax Under White Paper (Ontario)	U.S. Income Tax After Reform (Ohio)	<u>U.S. Tax Lower than Canadian Tax</u>	
			<u>Amount</u>	<u>%</u>
\$ 8,000	\$ 1,044	\$ 500	\$ 544	52.11
12,000	2,327	1,159	1,168	50.19
15,000	3,370	1,708	1,662	49.32
25,000	7,434	3,941	3,493	46.99
50,000	19,631	12,809	6,822	34.75

It is also interesting to note that Ontario, which levies provincial income tax equal to the federal abatement, has been selected as the province of residence of the Canadian taxpayer, while in actual fact the provinces of Newfoundland, New Brunswick, Manitoba, Saskatchewan, and Alberta levy provincial income taxes in excess of the 28% abatement allowed against federal tax. No allowance has been made in these tables for the higher total Canadian taxes which would be incurred by residents of these provinces, but it should be realised that the differential between Canadian and United States personal income taxes would be greater than indicated in this study, where the Canadian taxpayer resides in one of these provinces. For example, a United States taxpayer resident in Ohio and earning \$8,000 a year would pay 55.91% less tax than his Canadian counterpart residing in Manitoba (in 1970 and subsequent years) while for a Manitoba resident making \$25,000 a year the gap would be 51.18%.

U.S. Tax Position of the Homeowner:

A comparison of Canadian and United States personal income taxes would not be complete without some consideration of the relative tax positions of Canadian and United States homeowners. The United States homeowner has an additional advantage over his counterpart in Canada in the same relative income bracket, because the U.S. taxpayer is permitted to deduct his home mortgage interest and property tax payments in computing his taxable income for United States tax purposes.

In the previous tables, a comparison has been made of "average" taxpayers, and statistical average deductions were used in the calculation of both Canadian and United States taxable income. However, the average deductions used in the computation of United States taxable income reflect the deductions of both homeowners and tenants, and hence do not reveal the full impact of the mortgage interest and property tax deductions available to the homeowner in the U.S. In the following table, the United States income tax has been recalculated on the basis that the United States taxpayer is a homeowner resident in New York state; in the computation of United States taxable income, actual mortgage interest, property tax and other tax deductions (based on the assumptions as set out on Appendix A/4) have been used in place of the statistical average deductions claimed by the U.S. taxpayers for these items. The Canadian tax figure is unchanged from Table IV, since the Canadian's income tax position is unaltered by the fact that he is a homeowner:

A COMPARISON OF AVERAGE HOMEOWNERSTABLE V

(Where U.S. taxpayer is resident in New York state)

<u>Total Income</u>	<u>Canadian Income Tax Under White Paper (Ontario)</u>	<u>U.S. Income Tax After Reform (New York)</u>	<u>U.S. Tax Lower than Canadian Tax</u>	
			<u>Amount</u>	<u>%</u>
\$ 8,000	\$ 1,044	\$ 473	\$ 571	54.69
12,000	2,327	1,181	1,146	49.25
15,000	3,370	1,772	1,598	47.42
25,000	7,434	4,274	3,160	42.51
50,000	19,631	13,948	5,683	28.95

Moreover, a comparison on the same basis with a United States homeowner resident in the state of Ohio would reveal the following:

ANOTHER COMPARISON OF AVERAGE HOMEOWNERSTABLE VI(Where U.S. taxpayer is resident in the state of Ohio)

<u>Total Income</u>	Canadian Income Tax Under White Paper (Ontario)	U.S. Income Tax After Reform (Ohio)	<u>U.S. Tax Lower than Canadian Tax</u>	
			<u>Amount</u>	<u>%</u>
\$ 8,000	\$ 1,044	\$ 416	\$ 628	60.15
12,000	2,327	1,007	1,320	56.73
15,000	3,370	1,486	1,884	55.91
25,000	7,434	3,488	3,946	53.08
50,000	19,631	11,636	7,995	40.73

Thus it can be seen that an average married United States homeowner in the income brackets noted above may incur less than one-half of the personal income tax burden as is suffered by his Canadian counterpart. It should be noted that Tables III and IV represent comparisons of "average" taxpayers in each country, and hence reflect the impact of home ownership to some degree; Tables V and VI are applicable only where it is desired to compare the tax burdens of specific homeowners in each country.

Capital Gains:

The White Paper proposes that the Canadian citizen will incur a tax burden (approximately 25% for taxpayers in top marginal brackets) on his capital gains comparable to his United States counterpart, where he restricts his trading activities to shares in widely-held Canadian corporations. It should be noted, however, that Canadians in nearly all income brackets will suffer a heavier tax burden on capital gains on all other classes of assets, such as foreign securities and real estate, since, under the White Paper, these types of gains will constitute ordinary income for Canadian tax purposes taxable at full marginal rates; for U.S. tax purposes, gains on all types of assets held for over six months are subject to the 25% limitation (except that gains in excess of \$50,000 may be subjected to as much as 35% taxation). For instance, the taxpayer in the \$25,000 salary income bracket who realises a gain of \$10,000 on the sale of investment real estate (or foreign securities), would incur additional tax in respect of the gain of \$4,927 as a Canadian, as compared to a tax of Cdn. \$2,003 as a United States taxpayer; even at the \$10,000 salary level, the Canadian taxpayer would incur \$2,500

more tax on the gain than his United States counterpart. If the gain was applicable to shares in a widely-held Canadian corporation, the Canadian taxpayer in the \$25,000 income bracket would incur tax of \$2,367 on the gain - \$364 more than a United States taxpayer in the same bracket. (For these comparisons, it has been assumed that the U.S. taxpayer involved is an "average" American, resident in New York state, as in Table III.)

The comparisons herein do not reflect this disparity in the proposed Canadian and current United States tax treatment of capital gains; its effect would have to be determined according to the specific circumstances in each individual's case.

Other Considerations in Making Comparison:

Many different factors must be taken into consideration when comparing Canadian and United States personal income tax burdens, and no single comparison can represent the "true" differential applicable to all individuals and circumstances. The above tables have illustrated how the comparison can vary according to the hypothetical taxpayer's level of deductions, his state or province of residence, his marital status, and his personal situation (e.g. whether or not he is a homeowner). The comparisons presented herein are based on the assumption that the taxpayer's sole source of income is from employment, and it has been pointed out that a different comparison would emerge in the event that a portion of the taxpayer's income was from capital gains. On the other hand, the Canadian tax treatment of most domestic dividend income is more favourable than the United States tax treatment of similar income, and hence a more favourable comparison might result if it were assumed that the taxpayer derived a portion of his income from dividends from companies located in his own country. There are also many other differing provisions in the Canadian and United States tax laws (such as treatment of stock option benefits, lump sum payments, and retirement savings contributions) which would alter the comparison of situations where these provisions would apply.

It is not possible to produce one comparison which would reflect all of these differences in Canadian and United States tax laws in all circumstances, nor is it feasible in this type of study to present a full series of comparisons which would cover each possible situation of the hypothetical

taxpayer. Therefore, our analysis has been limited to a comparison of the personal income tax burdens of average wage and salary earners only, in an attempt to draw a general conclusion as to the comparative levels of Canadian and United States taxation on this specific type of income (which, of course, would constitute the major proportion of most taxpayer's income).

It will be noted that the comparison has been based upon taxes computed under the White Paper tax reform proposals and the United States Tax Reform Bill amendments after full implementation of these proposals and amendments, and hence that the differential may vary during the transitory or "phasing-in" period.

Any comprehensive comparison of the burden of taxation on Canadian and United States taxpayers should take into account all taxes that bear on the individual, and not only personal income taxes. (It is far beyond the scope of this study to attempt a comparison of such taxes as city income taxes, commodity sales taxes, estate taxes, succession duties, property taxes, etc.; the impression might be that the level of these types of taxation on an overall basis does not vary greatly between Canada and the United States, but no general conclusion is drawn in this regard.) To be even more meaningful, such a study would also have to encompass the relative benefits and services provided by governments to taxpayers; again, any such study is not within the scope of this bulletin.

Passing the Burden to Canadian Employers:

It was previously noted that the White Paper acknowledges the fact that Canada must compete with other foreign countries, most particularly the United States, for many types of professional and skilled labour, and that a significantly higher level of Canadian taxation as compared to United States tax levels may encourage talented Canadian individuals to relocate in the United States. It has been suggested by Finance Minister Benson, among others, that Canadian employers who are competing for skilled and professional labour with the United States will have to absorb the higher Canadian tax costs to the potential employee by paying him a higher salary than that which prevails in the United States for his particular skill, in order to overcome the competitive disadvantage of higher Canadian personal taxes. However, the cost to the Canadian employer of providing this parity

would be high; for instance, based on Table III, the following gross salaries would have to be paid to Canadian employees in order to yield them the same after-tax income as they would realise if they were to accept a similar position in the United States (New York state):

Salary that would be obtainable in				
the United States (Cdn \$)	\$10,000	\$15,000	\$25,000	\$50,000
U.S. federal and state tax				
thereon (Cdn \$)	932	2,036	4,791	15,202
Net after-tax income obtainable				
in the United States	\$ 9,068	12,964	20,209	34,798
<u>Canadian Salary required:</u>				
Net after-tax income to be				
provided	\$ 9,068	12,964	20,209	34,798
Federal and Ontario income taxes	2,021	4,200	9,805	24,266
Gross salary required	\$11,089	17,164	30,014	59,064
Amount of premium payment required	\$ 1,089	2,164	5,014	9,064
Premium payment as percentage				
of "base" salary	10.89%	14.43	20.06	18.13

The above figures are based on the assumption that the Canadian employer would have to provide the employee with complete parity with his United States counterpart. In some cases, such complete parity would not be necessary since many factors other than income tax considerations would enter into the skilled Canadian's decision to leave Canada and accept employment in the United States; nevertheless, the Canadian employer would have to pay a salary on a level sufficient to assure that the taxation differential does not become an overriding factor in the employee's decision. Most professional and skilled salary levels are already significantly higher in the United States than they are in Canada, and it is possible that many Canadian employers will find it difficult to pay the salary premiums required to equalize the income tax differential, as well as the general salary level, in order to attract or hold skilled personnel in competition with job offers from the United States.

Conclusion:

For the reasons previously noted, we do not feel that any single comparison can absolutely delineate the difference in the personal income tax burdens of Canadian and United States taxpayers. However, based on our analysis of the difference in impact of these two tax systems on middle and upper bracket salary and wage earners, we have concluded that the burden of personal income taxes in Canada, at least on employment and professional income, is in general very substantially higher under the White Paper proposals than will be incurred in the United States under the U.S. Tax Reform Bill of 1969. Although the actual amount of the differential on this type of income cannot be specifically defined, we have concluded that in many cases skilled Canadian personnel would find themselves paying anywhere between 50% to 100% more personal income taxes because they live in Canada rather than in the United States. If the comparison is between two taxpayers at similar levels who own their homes, the Canadian counterpart may quite likely incur double the personal income tax burden of the United States taxpayer; where the taxpayers do not own their homes, or are not married, the difference in relative tax burdens would be less.

We feel that the computations outlined in Tables III to VI summarize a number of appropriate ways of comparing United States and Canadian tax burdens at various income levels and under various circumstances. (For ease of reference, these tables have been summarized on the attached schedule.)

The individual income of Canadians is substantially lower - perhaps as much as 37% lower - than the income of United States residents. This in turn means that the personal tax base in the United States is substantially broader than it is in Canada, due to the higher income of United States citizens. However, in at least a number of important respects, the various governments in Canada have been attempting to provide a level of government services, including health, welfare and education benefits, which is at least somewhat comparable to those provided by the various levels of United States government for its citizens. Indeed, government services provided in Canada with respect to hospital and medical services and family allowances are generally superior to those provided in the United States. As

just one further example, it might be noted that expenditures by all levels of government in Canada on education take what may be the highest percentage of gross national income of any country in the world. All of such services must, of course, be supported by taxation revenue.

Since the Canadian per capita income, and tax base, is significantly lower than is available in the United States, the natural result is that Canadian levels of taxation will be higher than in the United States if Canadian governments attempt to provide comparable levels of benefits to their citizens.

Viewed in this light, the higher levels of personal income taxes in Canada, as compared to the United States, are a reflection, not of some defect in the Canadian taxation system or in the White Paper proposals, but of various governmental policies adopted with respect to expenditures. The tax reform proposals contained in the White Paper have not created the difference between Canadian and U.S. personal tax burdens, but if adopted, they would appreciably widen this already large gap.

If the differential in tax burdens between Canada and the United States in the area of personal income taxes, and perhaps elsewhere, is found disquieting, and if reduction is desired, then a re-examination of government expenditure patterns in Canada will be necessary in order to determine a means of reducing Canada's requirements for taxation revenues.

BASIS OF INCOME TAX CALCULATIONS USED
IN "WHITE PAPER HIGHLIGHTS" COMPARISON

General Assumptions:

- * 1. The taxpayer is married, and has two dependent children under the age of 16. Neither his wife nor his children receive any income of their own.
- * 2. The taxpayer derives his entire income from employment, and receives no additional investment or other income (including capital gains).
- 3. Canada Pension contributions (\$83) and U.S. social security contributions (\$374) are included in the respective Canadian and United States income tax totals.
- 4. No account is taken of the difference in value of the Canadian and United States dollar.

For Canadian tax purposes:

- * 5. The taxpayer resides in the province of Ontario, and Ontario income tax is included in total Canadian income tax.
- * 6. The tax calculations are based on the White Paper proposals, and they reflect the increased personal exemptions and the revised rate schedule (after full reduction in rates) as proposed in this Paper.
- 7. It is assumed that taxpayers with incomes of up to \$10,000 will claim only the standard deduction, and that taxpayers with incomes in excess of \$10,000 will deduct an amount equal to 2½% of their income in respect of donations and medical expenses. No account is taken of retirement savings contributions (including Canada Pension Plan) or the proposed \$150 allowance for employment expenses.
- * 8. Family allowance benefits are not considered in the computation of the Canadian tax liability.

For United States tax purposes:

- * 9. The taxpayer resides in the state of New York, and New York state income tax is included in total United States income tax.
- * 10. The taxpayer files a joint return.

11. The tax calculations are based on the rates and deductions in effect for the 1969 taxation year; the total tax figure includes the 10% surcharge.
12. It is assumed that taxpayers with incomes of up to \$12,000 will claim the standard deduction, and that taxpayers with incomes in excess of \$12,000 will claim deductions aggregating 5% of their income, as well as actual New York state income taxes.
13. For New York state tax purposes, it is assumed that taxpayers in all income brackets will claim only the standard deduction.

* These assumptions are common to all of the tax calculations used in this study.

BASIS OF INCOME TAX CALCULATIONS USED
IN COMPARISONS IN THIS STUDY*

General Assumptions:

1. Neither Canada Pension Plan contributions nor U.S. social security contributions are included in the related income tax totals.
2. Recognition has been given to the difference in value of the Canadian and United States dollar; an exchange rate of \$1 U.S. = \$1.075 Cdn. has been used in all conversions.

For Canadian tax purposes:

3. Deductions used in computing taxable income, such as for retirement savings plan contributions (including Canada Pension Plan) and charitable donations, have been based on statistical information compiled from "Taxation Statistics, 1969 Edition" (published by the Department of National Revenue); see Appendix A/3 for details. Recognition has been given to the \$150 allowance for employment expenses, as proposed in the White Paper.

For United States tax purposes:

4. The tax calculations on Table II are based on the rates and deductions in effect for the 1969 taxation year (including the 10% surtax); the tax calculations on the balance of the tables reflect the increased personal exemptions and termination of the surtax as enacted in the tax reform bill on December 30, 1969 (after full implementation).
5. Deductions used in computing taxable income, such as for medical expenses, contributions, taxes and interest, have been based on statistical information compiled from "Statistics of Income, 1967" (published by the Internal Revenue Service) and "Federal Tax Guide Reports" (published by Commerce Clearing House, Inc.); see Appendix A/3 for details. For additional assumptions made for deductions on Tables V and VI, see Appendix A/4.
6. For New York state tax purposes, it is assumed that the taxpayer claims itemized deductions, where applicable. It is also assumed that the taxpayer claims a deduction for insurance premiums (as allowed by that state) equal to 2% of his income.

* In addition to items marked (*) on Appendix A/1.

DETAILS OF COMPUTATION OF
STATISTICALLY BASED DEDUCTIONS

For Canadian tax purposes:

- (a) Average deductions claimed by taxpayers on their 1967 income tax returns (the latest year for which statistics are available), per the Department of National Revenue publication, "Taxation Statistics, 1969 Edition":

	Income Bracket				
	\$8-8,500	11-12,000	12-15,000	20-25,000	25-50,000
Medical (Net)	52	68	73	96	125
Charitable	49	103	141	331	593
Pension Plans	174	290	376	725	1,011
Other (excluding employment expenses)	43	38	31	40	77

- (b) Based on these statistics, it is assumed that the average taxpayer will claim the following deductions:

<u>Deductions:</u>	Total Income				
	\$8000	12000	15000	25000	50000
Retirement savings plans	\$ 243	383	483	833	1,183
Medical *	-	-	-	-	-
Donations	100	110	160	350	750
Other	40	35	30	50	100
Allowance for employment expenses	150	150	150	150	150

* Only non-reimbursed medical expenses would be deductible under the White Paper proposals.

For United States tax purposes:

- (a) Average deductions claimed by taxpayers on their 1967 income tax returns, per the Internal Revenue Service publication, "Statistics of Income, 1967":

<u>Income Bracket</u>	<u>Total Deductions Claimed</u>
\$ 7-8,000	\$1,522
10-15,000	2,116
20-50,000	4,160

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These statistics cover only those taxpayers who itemized their deductions (in lieu of claiming the standard deduction), but it is noted that 77% of all taxpayers with incomes in excess of \$10,000 did itemize their deductions in 1967.

- (b) Breakdown of average total deductions for the 1966 taxation year (1967 statistics not yet available), per Commerce Clearing House, Inc. publication, "Federal Tax Guide Reports":

<u>Deduction</u>	<u>Income Bracket</u>		
	<u>\$7-8,000</u>	<u>10-15,000</u>	<u>20-50,000</u>
Contributions	\$226	326	818
Interest	515	730	1,302
Taxes	463	712	1,603
Medical and Dental	357	414	1,031
TOTAL	\$1,561	2,182	4,754

- (c) Based on the above statistics, and extrapolating between income brackets, it is assumed that the average taxpayer will itemize his deductions and claim the following:

<u>Deductions</u>	<u>Total Income</u>				
	<u>\$8,000</u>	<u>12,000</u>	<u>15,000</u>	<u>25,000</u>	<u>50,000</u>
Contributions	\$ 200	300	350	400	1,000
Interest	500	700	750	1,000	1,200
Taxes*	450	700	700	1,200	2,000
Medical and Dental	350	300	400	600	800
TOTAL	\$1,500	2,000	2,200	3,400	5,000

* Includes average state income taxes. For purposes of the tax calculations in this study, a portion of this amount was deleted, and the actual state income taxes, if any, substituted therefor.

DETAILS OF COMPUTATION OF DEDUCTIONS
ASSUMED TO BE CLAIMED BY THE
UNITED STATES HOMEOWNERS

- (a) Statistical average deductions are used for contributions and medical expenses, as in Appendix A/3.
- (b) In place of statistical average deductions for taxes and interest, the following are substituted therefor:
- (i) Allowable sales and gasoline taxes, per Internal Revenue Service deduction tables.
 - (ii) Actual state income taxes, if any.
 - (iii) Assumed property taxes (see below).
 - (iv) Assumed home mortgage interest (see below).
- (c) Deductions for property taxes and home mortgage interest are based on the assumption that the taxpayer owns a home valued at between \$20,000 and \$75,000; that he carries a 7½% mortgage thereon in a principal amount equal to one-half of the home's value; and that he incurs annual property taxes equal to 2% of the home's value:

<u>Income level</u>	<u>Assumed value of home</u>	<u>Mortgage interest 7½%</u>	<u>Property taxes 2%</u>
\$ 8,000	20,000	\$ 750	\$ 400
12,000	30,000	1,125	600
15,000	35,000	1,313	700
25,000	50,000	1,875	1,000
50,000	75,000	2,813	1,500

COMPARISON OF CANADIAN AND UNITED STATES PERSONAL INCOME TAXES

SUMMARY

Gross Income	Cdn. Federal and Ontario Income Taxes	United States Federal and State (Where Applicable)				Personal Income Taxes				Average Homeowner Resident State of Ohio			
		Average American Resident New York State		Average American Resident State of Ohio		Average New York State		Average American Resident State of Ohio		U.S. Income tax		U.S. Income tax	
		U.S. tax lower % of Cdn. Tax	Amount	U.S. tax lower % of Cdn. Tax	Amount	U.S. tax lower % of Cdn. Tax	Amount	U.S. tax lower % of Cdn. Tax	Amount	U.S. tax lower % of Cdn. Tax	Amount	U.S. tax lower % of Cdn. Tax	Amount
		U.S. Income tax	U.S. tax lower % of Cdn. Tax	U.S. Income tax	U.S. tax lower % of Cdn. Tax	U.S. Income tax	U.S. tax lower % of Cdn. Tax	U.S. Income tax	U.S. tax lower % of Cdn. Tax	U.S. Income tax	U.S. tax lower % of Cdn. Tax	U.S. Income tax	U.S. tax lower % of Cdn. Tax
\$ 8,000	\$ 1,044	569	45.50%	475	54.4	500	52.11%	544	571	473	54.69%	628	60.15%
10,000	1,658	932	43.79	726	849	809	51.21	849	858	800	51.75	968	58.38
12,000	2,327	1,353	41.86	974	1,159	1,159	50.19	1,168	1,146	1,181	49.25	1,320	56.73
15,000	3,370	2,036	39.58	1,334	1,708	1,708	49.32	1,662	1,598	1,772	47.42	1,884	55.91
20,000	5,262	3,345	36.43	1,917	2,779	2,779	47.19	2,483	2,260	3,002	42.95	2,480	52.87
25,000	7,434	4,791	35.55	2,643	3,941	3,941	46.99	3,493	3,160	4,274	42.51	3,488	53.08
40,000	14,711	10,636	27.70	4,075	8,786	8,786	40.28	5,925	4,892	9,819	33.25	8,039	45.35
50,000	19,631	15,202	22.56	4,429	12,809	12,809	34.75	6,822	5,683	13,948	28.95	11,636	40.73

COMPARISON OF EFFECTIVE RATES OF CANADIAN AND UNITED STATES PERSONAL INCOME TAXES*

	CANADA		UNITED STATES	
	GROSS INCOME	GROSS INCOME	GROSS INCOME	GROSS INCOME
Canada Canadian federal and Ontario income taxes (as computed under the White Paper proposals Expressed as a percentage of gross income)	\$ 8,000	10,000	12,000	15,000
	1,044	1,658	2,327	3,370
	% 13.05	% 16.58	% 19.39	% 22.47
United States United States federal and state income taxes (giving effect to tax reform bill of Dec. 30, 1969) (a) average New York State resident - Total Tax (Cdn \$) Expressed as a percentage of gross income	\$ 8,000	10,000	12,000	15,000
	569	932	1,353	2,036
	% 7.11	% 9.32	% 11.28	% 13.57
(b) average homeowner in New York State Total Tax (Cdn \$) Expressed as a percentage of gross income	\$ 8,000	10,000	12,000	15,000
	473	800	1,181	1,772
	% 5.91	% 8.00	% 9.84	% 11.81
United States United States federal and state income taxes (giving effect to tax reform bill of Dec. 30, 1969) (a) average New York State resident - Total Tax (Cdn \$) Expressed as a percentage of gross income	\$ 8,000	10,000	12,000	15,000
	473	800	1,181	1,772
	% 5.91	% 8.00	% 9.84	% 11.81
(b) average homeowner in New York State Total Tax (Cdn \$) Expressed as a percentage of gross income	\$ 8,000	10,000	12,000	15,000
	473	800	1,181	1,772
	% 5.91	% 8.00	% 9.84	% 11.81

VANCOUVER BOARD OF TRADE

Commentaries and studies relating to
the Canadian White Paper on Proposals for Tax Reform

No. 3 : Proposal for periodic revaluation of shares
of widely-held Canadian corporations.

PERIODIC REVALUATION OF SHARES
IN WIDELY-HELD CANADIAN CORPORATIONS

The White Paper suggests that taxpayers be required to revalue shares which they held in widely-held Canadian corporations every five years and take one half of the resulting unrealised gain or loss into account for tax purposes in that year.

The reasons put forward for this suggestion are as follows:

- (i) Where a taxpayer must pay a tax upon the realisation of an investment, an economic theory suggests that he will tend to hold his investment for a longer period than he might otherwise do, so as to postpone paying the tax. Under this theory, the potential tax on realisation is said to "lock in" the investor to his investment. The White Paper suggests that causing the investor to pay tax on his unrealised gains would reduce this locked-in effect.
- (ii) The White Paper elsewhere recommends that although the estate of a deceased person would be required to value all assets at market value as of the date of the death, it should not be required to do so for income tax purposes.

In other words, the White Paper recommends that the estate of a deceased person should not be required to bring into income unrealised capital gains relating to assets of the deceased which had accrued as at the date of the death. However, the government evidently considers that an undue amount of tax postponement would result unless unrealised gains on investments in widely-held Canadian companies had periodically been taxed in the deceased hands in previous years.

- (iii) Where a taxation structure includes a tax levied on capital gains, problems inevitably arise as to the determination of the proper time at which to tax such gains. For instance, if two corporations merge in order to further their joint interests, the method of merger might be that the shareholders of one company might transfer their shares to the second company in exchange for an issue of shares out of the unissued share capital of the latter. In such circumstances, it may be that the value of the shares so issued exceeds the value of the shares transferred. Should the shareholders of the first company be subject to tax therefore in the

amount of that excess or should they only be taxed if and when they ever dispose of the shares which they have received from the second company?

The White Paper suggests that it would be more feasible for the government to classify such corporate mergers and other types of corporate re-organizations as "tax-free" transactions under a tax system which saw investors being taxed every five years on unrealised increases in the value of their shares in widely-held Canadian companies.

- (iv) The White Paper indicates that the ready marketability of shares in widely-held Canadian companies represents a kind of advantage to an investor which justifies eroding the concept of requiring the inclusion in income of only one half of the gain or loss incurred as a result of investing in shares in widely-held Canadian corporations.

Although in economic theory, an unrealised gain can be said to increase an investor's ability to command goods and services in an oblique manner, a truly neutral definition of income for tax purposes would not even include realised capital gains. The inclusion of unrealised gains in the income base would, therefore, represent a travesty of the "pure" income concept which would have to be followed if true taxation equity and neutrality were to be achieved. The periodic revaluation proposal impugns the sincerity of the government in its stated objective of increasing taxation equity and neutrality. (See paragraphs 1.8 and 1.10.)

As far as this Board's research has been able to determine, no other tax system in the world requires a revaluation of assets except to a very limited degree in the United Kingdom. One can only presume that taxing authorities in the rest of the world have concluded as has this Board that such a proposal is illogical and inequitable as indicated above, and, in fact, represents an unwarranted and unconscionable coercion of and intrusion into the affairs of investors.

Apart from the general principle involved, the five year revaluation proposal would be particularly onerous for controlling shareholders of companies which are listed on Canadian stock exchanges. Typically, the shareholders of a private or family corporation which has gone public may well have retained voting control. A five year revaluation proposal might

well create a tax liability of sufficient magnitude to require such controlling shareholder or shareholders to dispose of significant portions of their investment. Such disposition might even cause them to lose control of the companies involved.

Another particularly onerous situation which could arise from a five year revaluation rule would be where a foreign company owns a majority holding in a Canadian subsidiary whose shares are listed on a Canadian stock exchange. Inasmuch as such a foreign company would find itself subject to Canadian tax if the value of the shares of the Canadian subsidiary increased whereas another foreign company which owned all of the shares of the Canadian subsidiary would not, the former company would be justified in considering its tax treatment to be discriminatory. In fact, if the former company happened to be one which had caused its Canadian subsidiary to issue shares to the public in order to benefit from tax incentives offered for this purpose by the Canadian government some years ago, it would not be unreasonable to accuse the Canadian government of a breach of faith.

An examination of the government's reasons for putting forward the revaluation suggestion does nothing to minimise the repugnance with which the proposal will be met by most Canadians.

1. The White Paper postulates that the "locked-in" effect would impair the efficient functioning of the capital markets. The government has not, however, offered any empirical evidence to support this statement. The whole locked-in theory, in fact, is one which is not universally held, and although a tax on capital gains has not necessarily proved advantageous, the experience in countries such as the United States which have included in their tax structure for many years a tax on capital gains does not seem to indicate that the locked-in effect has had any drastic effect on capital markets.
2. With respect to the government's concern that an undue postponement of tax on unrealised gains would occur if a periodic revaluation was not demanded, it is difficult indeed to understand such concern when one considers that Canadian estate tax is now levied at a rate of 50% on an estate as low as \$300,000. Inasmuch as estate tax rates at such levels are impediment enough to the formation and application of private capital, it is incredible that any government in a free enterprise

country could think of adding a further disincentive to capital formation in the shape of periodic revaluations of unrealised gains.

3. Whilst it would be desirable to minimize the income tax problems arising upon corporate reorganizations, etc., which would occur under a capital gains tax situation, the government's use of this carrot as partial justification for the five year revaluation proposal is nothing more than a thinly veiled attempt to gloss over the omission of the White Paper to deal with the question of the formation of a Rulings Division of the Department of National Revenue. Such a Rulings Division has long existed in the United States and has long been needed in Canada. If the White Paper were to be implemented the need would be greatly magnified. Sooner or later, therefore, a Rulings Division will have to be created in this country. Income tax problems arising with respect to corporate reorganization, etc. would therefore become a natural subject of deliberation by such a Rulings Division.
4. With respect to the fourth rationalization put forward in the White Paper regarding the five year revaluation proposal, this is at odds with the White Paper's own explanation contained in paragraphs 3.34 and 3.35 as to why the taxation of gains from shares in widely-held Canadian corporations should be limited to one half thereof.

This proposal is utterly unacceptable to Canadians and its damaging effects and undesirable nature when combined with the relatively invalid reasons put forward for its introduction lead to only one conclusion - it should be withdrawn unconditionally.

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VANCOUVER BOARD OF TRADE

Commentaries and studies relating to
the Canadian White Paper on Proposals for Tax Reform

No. 4 : Proposal for the taxation of gains derived
from the sale of private homes.

TAXATION OF GAINS
DERIVED FROM THE SALE OF PRIVATE HOMES

At paragraph 3.19, the White Paper states "Generally, capital gains on the sale of homes would not be taxed". The same paragraph then goes on to suggest a formula relative to private home sales which, had it been in operation during the past six years would have guaranteed that virtually every house sale in Vancouver during those years would have resulted in a substantial payment of tax. Probably the same observation would be true of the other major cities in the country.

Between November 7, 1969 and the present time, Mr. Benson and his staff have been apprised of the effect which the formula set out in paragraph 3.19 would have had, had it been implemented five or six years ago. It is with great surprise, therefore, that one reads in the Minutes of Proceedings of the House of Commons Standing Committee on Finance, Trade and Economic Affairs on Thursday, 15 January that Mr. Benson reiterated that it was not the intention of the government to raise any revenue from the taxation of gains made on the sale of private homes.

If the government is sincere in this statement, therefore, it should immediately withdraw the proposal to tax gains on the sale of private homes or at a very minimum amend the proposal to provide exemption from tax in any case where the proceeds from the sale of a private home were applied to the purchase of another one within a reasonable period of time irrespective of whether any job change or geographic change was involved.

If the government is not sincere in its statement then the purpose behind the proposal must presumably be the production of revenue. If so, it should be understood that the proposal is capable of creating distressing tax liabilities in the hands of taxpayers of all walks of life including the many young couples struggling to provide adequate housing for growing families. Such results would represent a sardonic mockery of an objective of increasing taxation equity.

In the Appendix to this study there is shown a typical example of the hardship which the proposals set out in paragraph 3.19 could bring about.

There is some indication that the government might be prepared to liberalise the formula to some extent by increasing the annual amount which may be added to the cost basis of a private house from the \$1,000 suggested

in paragraph 3.19 to some higher figure. Such an increase would, of course, lessen the inequity of the proposal as it stands but such an approach is not really the most appropriate.

The most appropriate modification of the proposal is to exempt from tax all gains made on the sales of private homes except under certain narrowly defined circumstances. At a minimum, there should be granted an exemption from tax where the proceeds from the sale of a private home are applied in the purchase of another private home in which the taxpayer lives. Such an application should be made within a period of, say, 12 months from the sale of the former home.

The narrow circumstances under which it would be appropriate to tax gains made on the sale of a home, if an overall tax on capital gains were to be implemented, would be where a private home was built on or contiguous to substantial land holding other than farm land. If gains made under these circumstances were not taxed, a loophole for land speculation might arise. Such a loophole would be avoided if it was provided that no exemption or roll-over provision would be permitted with respect to gains made on the sale of a private house situated on or contiguous to a land holding of more than say five acres other than farm land.

APPENDIX

A taxpayer is married and had one child when he purchased a
1,000 sq. ft., 2 bedroom house for a total price of \$14,000*
(applying \$4,000* as a down payment)

He occupies it for 6 years.

Add to cost base: Cost of improvements - say	1,000
\$1,000 for each year of occupancy	6,000
	<hr/>
	\$21,000

Taxpayer now has three children and requires a larger house.
He, therefore, sells the house for \$26,500* less real estate
commission of \$1,375 \$25,125
(He obtains \$8,000 for a down payment and takes the balance
on an Agreement for Sale.)

Gain subject to tax under White Paper proposals	\$ 4,125
---	----------

Tax payable if taxpayer is in 36% marginal income tax bracket (based on employment income of say \$11,000 p.a.)	\$ 1,485
--	----------

If the taxpayer now purchases a 3-bedroom house of say 1,200
sq. ft. in any reasonable district, the cost will likely be
of the order of \$35,000*

He would probably be required to pay \$10,000 as a down payment.*

If he has \$2,000 savings he could, other things being equal, combine
that sum with the \$8,000 down payment received on the sale of his
former home and achieve the purchase of the larger house.

However, the tax payable of \$1,485 would prevent him from so doing
and represents therefore, a severe impediment to his chances of
effecting the purchase which he desires.

Such a taxpayer - at an \$11,000 p.a. level of employment income -
does not represent a wealthy citizen but one of a large group of white
and blue collar workers.

If the taxpayer's other income totalled only \$9,000 p.a. the tax on the
house gain would still be at the high level of \$1,427.

* Typical in the real estate prices which prevailed in Vancouver in
1963 and 1969.

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VANCOUVER BOARD OF TRADE

Commentaries and studies relating to
the Canadian White Paper on Proposals for Tax Reform

No. 5 : Proposal for taxation of gains made from
the sales of personal possessions.

TAXATION OF GAINS MADE FROM SALES
OF PERSONAL POSSESSIONS

Of all the proposals contained in the White Paper this proposal which would seek to tax gains made on the sales of property held for personal use or enjoyment is the most objectionable.

The amount of revenue likely to be produced by taxing such gains cannot possibly reach significant proportions. It is illogical therefore, to thrust an administrative burden on taxpayer and government alike which would considerably outweigh the amount of any revenue obtained. The costs of complying with such a proposal should not be underestimated.

The difficulties of valuation have, the Board believes, been underplayed. To extend these problems to the general area of personal possessions is completely impracticable. To state that this proposal is an invasion of privacy may be somewhat emotional but it must be recognised that this is an area which is likely to trigger strong feelings. Though it may be academically equitable to include such gains in the tax base, nevertheless the general taxpaying public will regard it as most unfair. This feeling will lead to non-compliance and the beginning of a general breakdown of tax morality.

If a particular taxpayer should receive disproportionate and/or recurrent gains from the sale of personal possessions it is still possible for such gains to fall within the tax net even under the present rules.

It is strongly recommended that this proposal be withdrawn. Failing this, and the Board is loath to suggest any alternative to complete withdrawal, it is recommended that no gains would be taxed unless the proceeds exceeded \$5,000 rather than the \$500 suggested.

VANCOUVER BOARD OF TRADE

Commentaries and studies relating to
the Canadian White Paper on Proposals for Tax Reform

No. 6 : Deemed realisation of market value of
assets of persons ceasing to be resident
in Canada.

DEEMED REALISATION OF MARKET VALUE
OF ASSETS OF PERSONS CEASING TO BE RESIDENT
IN CANADA

Where a tax structure includes the taxation of capital gains, it is reasonable to require that persons leaving the country should, at that time, be treated as though they had sold all their assets on the day of leaving at their fair market value, otherwise an elementary loophole exists for those who would seek warmer and less taxing climates.

No objection is taken, therefore, to the proposal set out in paragraph 3.40 of the White Paper except that it would represent an onerous requirement for non-residents who spend a limited period of time in this country and for Canadian residents who spend a limited period of time elsewhere. This type of limited duration movement across the Canadian border occurs very frequently as between Canada and the United States. It is universally agreed that nothing but good can come from interchange of talents between Canada and the United States and with other countries.

It is suggested, therefore, that the proposal in paragraph 3.40 be modified so that if a tax on capital gains were to be introduced in Canada, a deemed realisation of assets would not be called for except in cases where former non-residents spent more than two years in Canada or where Canadian residents spent more than two years outside of Canada. It would be realistic to require that, in the case of Canadian residents leaving Canada to spend time elsewhere, security be lodged with the government prior to leaving the country in the amount of the tax liability which would arise if a person remained outside of Canada for more than two years.

Irrespective of the foregoing, where a person was subjected to a tax assessment as a result of valuing assets on leaving the country, it is suggested that he be permitted a period of two years in which to carry back to that assessment any loss incurred as a result of actually disposing of any of the assets which were valued upon his departure from the country. This suggestion is made in the interest of a greater fairness towards those persons who might be required to take up overseas appointments at relatively short notice and who would not, therefore, have the opportunity to carry out an orderly disposition or transfer of their assets during their remaining period of residency in Canada.

Again with regard to the foregoing, it is suggested that a person who has revalued his assets upon leaving the country and who subsequently re-enters Canada be permitted, with one exception, to regard the departure revaluation as his cost basis for future Canadian tax purposes. The exception would relate to a less than 25% interest in a widely-held Canadian Company. It is suggested that the taxpayer be permitted upon re-entry into Canada to value such shares at the greater of the fair market value at the date of departure or at the date of re-entry.

VANCOUVER BOARD OF TRADE

Commentaries and studies relating to
the Canadian White Paper on Proposals for Tax Reform

No. 7 : Deemed realisation upon the gifting of
assets.

DEEMED REALISATION UPON THE GIFTING OF ASSETS

Under paragraph 3.41 of the White Paper, it is suggested that a person making a gift should be treated as if he had sold the asset at its fair market value and then made a gift of the proceeds. If the asset had increased in value beyond its cost basis in the hands of the donor, the latter would then be subject to a tax on the increase if the White Paper proposals relating to the taxation of capital gains were implemented.

Parliament recently enacted changes in the gift tax provisions so that a person could give assets up to any value to his spouse without incurring any gift tax. The proposals set out in paragraph 3.41 would appear to be inconsistent with the changes in the gift tax provisions where the gift involved is made by one spouse to another.

The Vancouver Board of Trade recommends, therefore, that gifts between spouses should not be subject to any deemed realisation rule.

VANCOUVER BOARD OF TRADE

Commentaries and studies relating to
the Canadian White Paper on Proposals for Tax Reform

No. 8 : Valuation of Assets on "Valuation Day".

VALUATION OF ASSETS ON "VALUATION DAY"

Ever since the White Paper was published in November of 1969, it is this Board's impression that the government has been at pains to minimize the valuation burdens which would fall on the people of Canada if the proposals of the White Paper to tax capital gains were to be adopted. The Board does not agree with the government's views in this regard and does not feel that there is any exaggeration in the prediction that the valuation of most of the capital assets in the country would prove to be a staggering burden on the individual and corporate taxpayers of Canada.

In fact, a careful consideration of the true scope of the valuation problem could lead one on this ground alone to reject the proposal to tax capital gains. However, if a tax on capital gains were to be introduced, this Board would strongly recommend that at least one other basis should be permitted for the valuation of assets as an alternative to computing or appraising their fair market value.

The alternative which the Board considers would be the most useful, would permit a taxpayer to pro-rate a realised gain or loss over the holding period of the asset.

Revenue authorities frequently object to this type of alternative because, given a full option, a taxpayer would only adopt such a method if he estimated that it would produce less tax than would result from retroactively valuing his asset as of Valuation Day. If, however, the alternative method of election were restricted in some manner, the revenue authorities' objections would be largely met and some relief from the burdens of valuation would be offered.

Accordingly, it is recommended that if a tax on capital gains were introduced, taxpayers be permitted a two year period following Valuation Day in which to choose with respect to each of their capital assets which of the two methods they would prefer to adopt in determining the value of their assets as of Valuation Day.

VANCOUVER BOARD OF TRADE

Commentaries and studies relating to
the Canadian White Paper on Proposals for Tax Reform

No. 9 : Elimination of Low Rate of Corporate Tax.

ELIMINATION OF LOW RATE
OF CORPORATE TAX

As part of its proposals to integrate corporate taxes and the tax liability of shareholders, the White Paper proposes that the low rate of corporate tax be eliminated over a transitional period of four years (the White Paper speaks of the transitional period of five years but it is actually four as set out in paragraph 4.30).

At the present time, corporations which are not associated with other corporations are subject to a corporate tax rate of 21% on the first \$35,000 of taxable income and at a rate of 50% thereafter.

Because of the capital bias against small businesses, the latter have traditionally raised much of their capital from internal cash flow. It was in recognition of this fact that the dual rate of corporate tax concept was initially introduced in 1949. At that time the Minister of Finance in suggesting a dual rate of corporate tax said:

"The House will at once recognize this as tax relief for small businesses and will, I trust, be heartily in accord with the policy. Our country as a whole owes a great deal to the small family type of business."

Although the rates and amounts of taxable income on which the low rates is applied have varied over the years, the principle involved has remained unchanged. It is true that the Industrial Development Bank has done an excellent job in providing crucially needed financing for certain companies over the past several years. Nevertheless, the loss of cash flow which will be brought about by the elimination of the low rate of corporate tax will impair the abilities of many small companies to expand and may, in fact, spell the difference between success and failure for others. The actual loss of cash flow of approximately \$10,000 per annum is magnified to the extent of the shrinkage of credit available to those companies which are in a position to borrow funds.

The method by which the concept of a dual rate of corporate tax was introduced into the Income Tax Act was, however, at odds with its objective of offering relief for small businesses. Specifically, the low rate relief was:

- (a) Available to all corporations irrespective of size or profit level.
- (b) Available to all companies irrespective of the income level of the shareholders thereof.
- (c) Open to abuse which was difficult to police.

The last point led to a substantial amount of abuse in the forms of unnecessary proliferation of companies which were not associated in the legal sense but which, nevertheless, were relatively closely connected in a more general sense. Furthermore, individuals who incorporated themselves were in a position to minimize taxes on what was, essentially, employment and property income by the use of a relief which was intended to foster the growth of business income.

A further criticism of the dual rate concept which is mentioned in the White Paper and which has been elaborated upon by Mr. Benson in his comments to the House of Commons Standing Committee on Finance, Trade and Economic Affairs refers to the inability of proprietors of unincorporated businesses to apply to their business income a rate of tax lower than their marginal rate. Apart from professional people, however - who, in most cases, may not incorporate - there is little to prevent the proprietor of an unincorporated business from incorporating. The costs of incorporation of a small business would usually be measured only in hundreds of dollars and, accordingly, a proprietor who would be deterred from incorporating by such costs is likely to be liable to only a low rate of individual tax in any event. The condemnation of the low rate of corporate tax on the grounds that unincorporated businesses do not receive the benefit from it would appear, therefore, to be based on rather specious reasoning.

Since the issuance of the White Paper, the government has given some indication that it considers the encouragement of small and new businesses to be a desirable objective. The granting of accelerated rates of depreciation to new and small businesses has been suggested as one possible means of offering such encouragement. The relief which would be so offered, however, would obviously be of little use to companies whose activities did not require a significant investment in depreciable property. There would be few who would deny that the Canadian economy benefits from the growth of sound service industries such as, for example, Engineering and Design,

Computer Software, Insurance, etc. New businesses in such fields will frequently require a build up of working capital in order to expand in a healthy manner but in their cases the capital might be required to build up teams of competent staff rather than to expanded physical facilities.

All in all, it would seem that some modification of the existing situation would best achieve the objective of encouraging small and new businesses whilst at the same time curbing the deficiencies of the existing system.

Specifically, it is suggested that the low rate of corporate tax continue to be applied to the first \$35,000 of taxable income but only in the cases of individual corporations or groups of associated corporations whose aggregate annual income does not exceed \$100,000.

The Board considers that the Department of National Revenue - utilizing the tools available to it under the present Income Tax Act - has already succeeded in large measure in curbing the abuse of the low rate system caused by artificial proliferation of companies. However, in order to reduce the temptation to artificially limit income to such a \$100,000 level, it would be as well to cushion such an ineligibility test by way of a notch provision. Under such an approach, the amount ineligible for application of the low rate of corporate tax would be reduced by one dollar for every dollar by which the income of the corporation (or group of corporations) exceeded \$100,000.

In considering the matter of a low rate of corporate tax, it should be remembered that if the White Paper proposal to integrate corporation and shareholder taxes were to be enacted, the low rate of corporate tax would no longer represent a true tax loss to the government but only a deferral. In any case, where the corporation merely utilized the increase in its cash flow resulting from the lower rate of tax to increase bonuses or dividends to its shareholders, the government would quickly recover the amount of tax lost as a result of granting a low rate of corporate tax. On the other hand, where a corporation made use of the increase to consolidate or improve the economic health of the company, the government would have increased revenue in the future as a result of improved corporate profitability.

VANCOUVER BOARD OF TRADE

Commentaries and studies relating to
the Canadian White Paper on Proposals for Tax Reform

No. 10 : Proposal that corporations distribute
earnings within $2\frac{1}{2}$ years in order to
preserve creditable tax.

A DISCUSSION OF THE PROPOSAL THAT CORPORATIONS
DISTRIBUTE EARNINGS WITHIN TWO AND A HALF YEARS
IN ORDER TO PRESERVE CREDITABLE TAX

Paragraph 4.27 of the White Paper proposals states:

"For the shareholder to receive credit for tax paid by a corporation, the corporation would have to pay the appropriate dividends - either in cash or stock - within a limited period of time. It is proposed that tax paid with respect to a given taxation year should be creditable only if it is passed through to the shareholders within 2½ years from the end of the corporation's tax year"

Such a rule would, in practice, give rise to certain inequities and disadvantages. Thus -

1. Closely-held Corporations

- (a) Notwithstanding the integration of fifty percentage points of corporate tax paid by closely-held companies with taxes payable by shareholders thereof with respect to dividends, an enforced dividend distribution will give rise to inequity to some extent. This follows from the fact that even in those Provinces which levy income tax at a level of only 28% of federal tax, a tax of 2.4% would be payable on the amount of dividends received by shareholders in the top bracket of tax following the transitional years (during the transitional years much greater rates of tax would be payable by higher bracket shareholders). It should be remembered that the top rate of tax becomes payable under the White Paper proposals by persons whose taxable income is \$24,000 or more.

In Provinces which levy a greater rate of tax than 28% the tax payable on the receipt of dividends would be higher than that noted above. In Manitoba, for instance, the present rate of income tax is 39% of federal tax. After transition, therefore, it would cost shareholders in Manitoba, whose taxable income is \$24,000 or over, 11.2% on the amount of dividends received from closely held Canadian companies.

- (b) Where closely-held companies wished to retain a portion of corporate earnings for working capital or expansion purposes, a 2½

year rule would necessitate the company issuing stock dividends or alternatively, requesting shareholders to loan back to the company amounts distributed as cash dividends. Although no overwhelming disadvantage obtains from either of these procedures, the financial statements of the closely-held companies would become rather awkwardly structured which might be somewhat disadvantageous if the company were to be sold or listed on a stock exchange at a later date.

2. Widely-held Corporations

Many widely-held corporations are accustomed to paying a steady flow of dividends despite year to year fluctuations in profits. In these numerous cases, the companies would, therefore, be forced to decide whether to permit substantial portions of their creditable tax pools to become staledated or whether to preserve the creditability by increasing the amount of earnings distributed by additional cash dividends, stock dividends, or a combination thereof.

In many instances, an increase in the cash dividend policy would not be palatable because of working capital or expansion financing requirements and if a stock dividend procedure were followed, shareholders would presumably demand some extra cash dividend to provide funds to pay the tax to which the stock dividends would give rise. (It must be remembered that stock dividends will be just as taxable as cash dividends, and in the case of widely-held companies, the shareholder would be entitled to credit only one half of his share of the corporate tax previously paid by his company.)

Irrespective of the probable demand for a further cash dividend to accompany a stock dividend, the latter will itself give rise to many problems. For example, should a company issue a stock dividend on common shares - thus diluting existing stock outstanding, should it declare a stock dividend of preferred shares - in which case, should they be redeemable, non-redeemable, carry a cumulative dividend, carry a non-cumulative dividend or carry no dividend at all?

If preferred shares of one kind or another were to be used as a vehicle to effect a stock dividend, problems of valuation for capital gains tax purposes would arise.

The concepts of integration and of a tax on capital gains as set out in the White Paper would give rise to conflicting objectives of different categories of shareholders with respect to dividend policy. A 2½ year distribution rule would exacerbate the problems to which such conflicting objectives would give rise.

3. Variations from Normal Taxable Income Computations

For a variety of reasons, it will commonly occur that companies - both closely-held and widely-held - will suffer an effective rate of tax on earnings which in some years will be less than, and in other years more than, a "normal" 50% rate of corporate tax. In the absence of something like a 2½ year distribution rule, such companies frequently would be able to stabilize the creditable tax flow-through at a 50% rate or - in the case of widely-held companies - 25% if they so wished, by relating dividend flows to the amounts in their creditable tax pools. A 2½ year rule would restrict their ability to follow such a procedure.

The application of losses carried over from other years, incentives available to the mining and oil industries, would give rise to instances where tax paid would fall short of 50% of the year's earnings. Timing difference arising from differences in the tax and accounting treatment of depreciation, deferred charges, inventory valuations, etc., could give rise to instances where the effective tax rate on earnings in any given year would be less than or more than 50%.

Two reasons are given in the White Paper for the proposed 2½ year rule:

1. "If corporations accumulated creditable tax for 10 or 15 years large dividends at the end of that time could seriously affect government revenues in the year of distribution." Such a phenomenon is commonly known as "bunching" of dividends.
2. The rule would "reduce the temptation to taxpayers who cannot make use of creditable tax to "sell" it to taxpayers who can make use of it".

The validity of these two reasons is analysed with great care in the Appendix to this study. The conclusions reached are that:

- (a) The fears that dividends would bunch in any one year would appear to be unfounded, and

- (b) The minimization of "creditable tax" sales could be achieved by other means.

This Board concludes that the validity of the reasons put forward by the government for introducing the proposed $2\frac{1}{2}$ year distribution rule is so imperfect that the weight of such reasons falls far short of the disadvantages listed above that would arise from the implementation of such a $2\frac{1}{2}$ year distribution rule. It is strongly suggested, therefore, that if the "integration" proposals of the White Paper were to be adopted, they should be implemented without the $2\frac{1}{2}$ year distribution requirement.

APPENDIX TO PART B - STUDY NO. 10THE BUNCHING OF DIVIDENDS

Table 1 shows gross dividends received by Canadian individual taxpayers in the most recent 12 years for which published information is available.

The Table then shows a comparison of the dividend figures with the total incomes of all individual Canadian taxpayers for the same years. This comparison indicates a stable relationship between total incomes and the total dividend receipts. For each of the 12 years the actual ratios of dividends to total incomes were calculated and were found to vary between 15.5% for 1963 and 17.9% for 1965; the mean being 16.78%. The deviations from the mean were also calculated. The standard, or "average", deviation was found to be .633%. Translated into terms of the most recent dividend figures such an average deviation would amount to \$24 million.

For practical purposes this would mean that, given an estimated total income figure for any one year, and given all other things equal, it should be possible to forecast the total gross dividends that individuals would receive in that year, to within \$50 million, with a high degree of certainty.

It serves no useful purpose to calculate what would happen to dividends if total income of individuals were to deviate substantially from estimate. The deviation in total income alone would cause budgetary embarrassment in excess of that arising from a variance in the estimate of dividend flow.

The conclusion to be drawn from the calculations shown on Table 1 is that dividends received by individual Canadian taxpayers have shown no tendency to bunch in the past. This constitutes a strong indication that bunching will not take place in the future.

Although the relationship between total dividend receipts and total taxable incomes of individuals is not as pertinent to the objective of predicting future dividend flow, as is the ratio of dividends to total income, the trend of such relationships during the same 12 year period was nevertheless established by regression analysis. The result of such analysis supported the above stated conclusion.

A similar analysis was performed on historical data of dividends received by corporations taxable in Canada. In order to gain an appreciation of the significance of these dividends, the total figure reported by all profitable

corporations on their income tax returns for 1967 was \$1,037 million. Again, analysis shows that bunching has not occurred in the past, and given all other things equal, is not likely to occur in the future. However, these considerations are not particularly relevant to the problem under study. As a general rule, dividends received by a corporation would have no effect on government tax revenues under either the present or the White Paper proposals. The impact is only felt when creditable tax flows through to the individual shareholder.

The possible bunching of dividends paid by corporations to other corporations is, therefore, of little consequence.

Under the White Paper proposals, the system of gross up and credit generally would yield to an individual receiving dividends from a widely-held corporation, a tax refund if he is in one of the lower income brackets and an additional tax if he is in a higher income bracket. Individuals receiving dividends from closely-held corporations would in most cases be entitled to some tax refund - particularly in the years following the transitional period.

Table 2 of the Appendix shows the amount of gross dividends received by individual Canadian taxpayers in the year 1967 (the most recent year for which such statistics are available), broken down by income groups.

The degree of budgetary dislocation which might result from a bunching of dividends in any one year would depend, therefore, on the proportions of dividends from widely-held and from closely-held companies, and the manner in which the dividends fell into income groups.

The conclusions stated above indicate that the first motive for the proposal to introduce the $2\frac{1}{2}$ year rule is not well founded in that bunching of dividends is not likely to occur. Even if it did occur, the following paragraphs suggest that little if any embarrassment to government budgetary estimates would result.

Let it be assumed for illustrative purposes that the flow of dividends received by all individuals from widely-held corporations is three times greater than the flow of dividends from closely-held corporations. Under such circumstances, the Treasury could expect "tax refunds" to exceed "additional taxes" by a small amount. Based on 1967 figures, Table 2

indicates that the total of such net additional tax refunds would be of the order of \$25 million. This figure is 4% of the gross dividends figure of \$601 million.

In the event that unexpected bunching did occur, Table 2 tends to show, therefore, that if the bunching arose from widely-held corporate dividends to the extent of 75% and from closely-held corporate dividends to the extent of 25%, the resulting drop in budgeted revenues would be of the order of 4% of the abnormal increase in dividend flow.

Earlier it was calculated that, given a total income for individuals, gross dividends could be estimated within \$50 million with a high degree of certainty. If a variation of such an amount were to take place in the future, then under the White Paper proposals the Treasury would suffer an unexpected net outflow of \$2 million (\$50 million x 4%). Clearly, this figure is not material.

If the bunching resulted from widely-held corporate dividends to an extent greater than 75% the resultant drop in budgeted government revenues would be even smaller and could even give rise to an increase in government revenues. On the other hand, the effect on government revenues would be more serious if a bunching occurred wholly or primarily as a result of increased closely-held corporate dividend outflow.

However, it should be recalled that the total government revenues in the year 1966/67 for instance amounted to \$8,376 million. Such a figure simply dwarfs the amounts of budgetary dislocation which are statistically likely to result from the bunching of dividends.

To summarize, the possibility that dividends may bunch is not a valid reason for imposing the 2½ year rule because:

1. Statistics of past dividends reveal that it is highly improbable that bunching will occur in the future to any significant degree.
2. The net outflow of funds that bunching of dividends would bring about, if it did occur, would likely be - relatively speaking - very small.

THE SALE OF CREDITABLE TAX

Under the proposed system, it would be possible for taxpayers who are not entitled to make use of creditable tax accumulated by companies of which they are shareholders, to sell their shares to shareholders who could make

use of it, at prices advantageous to both parties. It would appear probable that the "creditable tax" sale phenomenon would be more pronounced with respect to shares of closely-held corporations rather than widely-held, because the inter-play of market forces are such that quoted prices are not likely to reflect accurately the worth or value of accumulated pools of creditable tax.

It is suggested, therefore, that unless actual experience revealed significant trends of pre-dividend sales by non-taxable shareholders the potential "creditable tax" sale problem should be ignored as far as widely-held companies are concerned. (It may be noted that if annual trends of this kind did develop a 2½ year rule wouldn't help at all.)

With respect to closely-held corporations, it would appear to this Board that sales of shares of companies with accumulated creditable tax pools could only be made to advantage by persons who were not subject to Canadian tax on capital gains. Paragraph 5.54 of the White Paper proposes that the investment income of charitable trusts and non-profit corporations should be subject to tax. This presumably means that such entities would be taxed on capital gains. Non-residents would be made subject to Canadian tax on gains made upon the sale of shares in closely-held Canadian corporations. So it would seem likely that only certain entities such as pension trusts would be in a position to benefit from the sale of shares in closely-held corporations which had accumulated pools of creditable tax.

Since the investment of pension trusts in closely-held Canadian corporations is relatively limited, the Board is not convinced that the problem of creditable tax "sales" would, therefore, be of any great magnitude. However, if the government continues to feel that it must have some sort of protection with respect to the sale of shares in closely-held companies which have accumulated creditable tax, it is suggested that a rule could be enacted under which the creditable tax entitlement of shareholders subject to Canadian tax would be reduced by the amount of creditable tax that would otherwise attach to shares which they purchased from shareholders not subject to Canadian tax. Compliance with such a rule could be largely effected by requiring special transfer procedures with respect to closely-held shares which were sold to Canadian taxpayers by non-residents, charitable and non-profit organizations and non-taxable pension and similar institutions.

The corporations involved would then be required to subtract any "prohibited-use" portion from the creditable tax shown on the purchasers' annual dividend (T5) slips.

* * * * *

TABLE 1
Analysis of Dividends as shown by the Canadian Tax Returns
of Taxpayers who are Individuals

(figures in millions of dollars)

Income Tax Returns for the Year	Gross Dividends Received*	Total Income of Canadian Individual Taxpayer*	Ratio ^o /oo	Square of Deviation from Mean
1956	243	14,356	16.9	.014
1957	262	15,629	16.8	.000
1958	280	16,225	17.3	.270
1959	296	17,448	17.0	.048
1960	315	18,578	17.0	.048
1961	328	19,602	16.7	.006
1962	347	20,764	16.7	.006
1963	347	22,422	15.5	1.638
1964	440	25,174	17.5	.518
1965	508	28,342	17.9	1.254
1966	558	34,249	16.3	.230
1967	601	37,837	<u>15.9</u>	<u>.774</u>
			<u>201.4</u>	<u>4.806^o/oo</u>

Mean ratio = 16.78 ^o/oo

Standard deviation (per mil) = $\sqrt{\frac{\sum (Y-Y)^2}{N}}$ = $\sqrt{\frac{4.806}{12} \text{ } ^o\text{/oo}}$ = .633 ^o/oo

Standard deviation (gross dividends) = .633 ^o/oo x 37.837 = \$24 million

* Source - Taxation Statistics, Department of National Revenue.

TABLE 2

ADDITIONAL TAX VS. (TAX REFUND)

(figures in millions of dollars)

<u>Income Group</u>	Under White Paper system, estimated additional tax or (tax refund), assuming dividends were received:			
	<u>Gross dividends received by individuals*</u>	<u>Entirely from widely-held corporations</u>	<u>Entirely from closely-held corporations</u>	<u>75% from widely-held and 25% from closely-held corporations</u>
0 - 1,000	4	(2)	(4)	(2)
1,000 - 2,000	13	(6)	(12)	(7)
2,000 - 3,000	20	(8)	(17)	(10)
3,000 - 4,000	21	(7)	(17)	(10)
4,000 - 5,000	23	(7)	(17)	(10)
5,000 - 10,000	108	(11)	(51)	(21)
10,000 - 15,000	88	-	(29)	(7)
15,000 - 20,000	61	6	(12)	2
20,000 - 25,000	44	7	(6)	4
25,000 - 50,000	105	21	(7)	14
50,000 - 100,000	61	15		11
100,000 - 200,000	34	9		7
Above 200,000	19	5		4
	<u>601</u>	<u>22</u>	<u>(172)</u>	<u>(25)</u>

* Source: Taxation statistics for 1967
Department of National Revenue

VANCOUVER BOARD OF TRADE

Commentaries and studies relating to
the Canadian White Paper on Proposals for Tax Reform

No. 11 : Transitional restriction of creditable tax.

TRANSITIONAL RESTRICTION OF CREDITABLE TAX

Where a closely-held company had on hand at "Valuation Day" certain capital assets which might give rise to tax under the new system if they were sold after the implementation of such new system, certain technical by-products of the White Paper's capital loss deduction and corporate tax integration proposals would actually cause such tax to be paid back to the shareholders of the company. The government, quite rightly, is not prepared to accept such a situation and suggests certain remedial procedures in paragraph 4.79 of the White Paper.

Under these remedial procedures, certain closely-held companies - including those which on Valuation Day owned businesses having a goodwill value of which owned depreciable property in respect of which depreciation had been claimed for tax purposes in prior years - would not be permitted to pass along to their shareholders in the form of creditable tax all of the corporate tax paid under the new system unless the shareholders of the companies elected to be treated as partners. This proposed procedure is inequitable and onerous for the following reasons:

- (i) Each closely-held company affected - and there would be many - would be required to make valuations of the worth of the company on two different bases within a short period of time following the implementation of the new system.
- (ii) The shareholders of such companies would not benefit from the integration proposals to the same degree that shareholders of unaffected companies would - thus creating a horizontal inequity.
- (iii) The shareholders of a number of corporations would not be in a position to make the partnership election and even those who were in such a position might have good reason not to do so.
- (iv) The overriding inequity of the proposed procedure lies in the fact that, in effect, the shareholders of the companies involved would in varying degrees depending on circumstances, be taxed in advance of their companies entering into the sales of goodwill or depreciable assets which represent the taxable transactions in question. In fact, in many instances the procedure would represent a taxation of transactions which might never take place.

This Board suggests that the government's position would be completely and equitably protected by the simple rule of diverting corporate tax away from creditable tax pools at such time as taxable sales of depreciable property or goodwill actually take place, if ever. The detailed mechanics of the Board's proposal in this regard have been included in a technical brief which has been forwarded to the Tax Policy Unit of the Department of Finance (see the final section of this brief).

VANCOUVER BOARD OF TRADE

Commentaries and studies relating to
the Canadian White Paper on Proposals for Tax Reform

No. 12 : Denial of deduction for entertainment
and related expenses.

DENIAL OF DEDUCTIONS FOR ENTERTAINMENT
AND RELATED EXPENSES

The proposal contained in paragraph 5.9 of the White Paper to deny deduction for entertainment expenses, the costs of attending or sending employees to conventions, and the cost of dues for membership in social or recreational clubs is an example of a lack of realism in the government's approach which shows through in certain areas of the White Paper.

The pressures of business today - arising in part from increasing specialisation and complexity - frequently make mandatory an attendance at conventions in order for businessmen or professional practitioners to keep abreast of current business and professional practices.

It must also be recognized that a tremendous amount of business discussions are carried on in clubs. And, in many cases, the business lunch or business entertainment represents the only effective form of advertising or business promotion for some types of business. To deny taxpayers a deduction for these types of expenses is, therefore, to put them at a disadvantage in maintaining and expanding their business.

To the extent that expenditures claimed for tax purposes are not reasonable in amount or are not laid out for the purpose of earning income, they can be disallowed by the Department of National Revenue under existing provisions of the Income Tax Act. However, it is recognised that the Department of National Revenue encounters certain difficulties in two respects:

- (i) Some taxpayers do not set forth clearly in their accounting records the amounts expended on conventions and entertainment, etc.
- (ii) Certain taxpayers who have been denied a deduction for certain type of expenditure, will continue to claim the same type of expenditure in subsequent years in the hope that their returns will not be subjected to intensive investigation each year.

In a separate technical brief addressed to the Tax Policy Unit of the Department of Finance (see the final section of this brief), the Board has suggested certain technical amendments to the Income Tax Act which would assist the Department of National Revenue with respect to the two problems referred to above.

Provided the assistance referred to in the preceding paragraph were accorded to the Department of National Revenue, the Vancouver Board of Trade suggests strongly that there would be no need for the proposal set out in paragraph 5.19 of the White Paper.

VANCOUVER BOARD OF TRADE

Commentaries and Studies relating to
the Canadian White Paper on Proposals for Tax Reform

No. 13 : Income Averaging

INCOME AVERAGING

The absence of a general income averaging provision has long been a deficiency in the Canadian income tax structure. It is very disappointing, therefore, to discover that the averaging proposal set out in the White Paper does little to remedy the situation.

The equity of a progressive rate income tax system is suspect enough without compounding it by providing inadequate relief in situations of fluctuating levels of income. A general averaging formula should relieve the taxpayer to a very substantial extent of the impact of the higher marginal rates of tax to which the irregular increase in his income would otherwise subject him. In Table 11 of the White Paper, an example is shown of the operation of the averaging formula suggested by the White Paper. In that example, the application of the averaging formula results in a saving to the taxpayer of \$446. However, it would require a further reduction of \$235 to bring the taxpayer back to where he would have been had his income been received evenly over the five years in question.

The Vancouver Board of Trade considers that equity would be better served by an averaging formula which:

1. Could be applied with respect to a period where income sharply dropped from the previous years' level in addition to a period where income sharply increased over previous year's level.
2. Provide relief more nearly equal to that resulting from an evening out of income levels during the averaging period.

VANCOUVER BOARD OF TRADE

Commentaries and studies relating to
the Canadian White Paper on Proposals for Tax Reform

No. 14 : Taxation of mining and oil companies.

TAXATION OF MINING AND OIL COMPANIES

It is the understanding of the Vancouver Board of Trade that several briefs will be submitted to the Parliamentary Committees wherein the impact of the White Paper proposals pertaining to the mining and oil industries will be examined in depth. Accordingly, this Board does not consider it appropriate to comment on these proposals at any great length.

The general observation must be made, however, that the steady growth over the past several years of these two industries has made a very significant contribution to the total wealth of this country. Furthermore, the mining industry in particular has assisted materially in correcting regional economic imbalances across the country. The growth of the two industries has been made possible by, or at a minimum, has been materially assisted by the incentive provisions at present contained in the Income Tax Act.

These incentives have, therefore, worked well and the reasons that they were needed arises from one thing and one thing only - capital invested in the mining or oil industry is placed there at a high degree of risk. The risk of non-discovery above all other things sets these two industries aside from other commercial and industrial concerns.

The risks inherent in these two industries have not changed. The material reduction in the mining and oil incentives which is proposed in the White Paper must necessarily, therefore, decrease the attractiveness of these two industries as an investment vehicle. As a result, it is likely that an implementation of the White Paper proposals in this regard would result in a slowing down of the growth of these two industries - a fact which is acknowledged to some extent by the White Paper.

Any contraction in the mining and oil industries in Canada would affect not only the total economy of the country but also could seriously affect particular regional economics.

The Vancouver Board of Trade considers, therefore, that the proposed reductions in incentives to the mining and oil industries represent too severe a measure. It is suggested that for as long as Canadians wish to emulate the standards of living enjoyed in the United States, any substantial impediment to the totality of Canadian economic growth should be studiously avoided.

VANCOUVER BOARD OF TRADE

Commentaries and studies relating to
the Canadian White Paper on Proposals for Tax Reform

No. 15 : Taxation of International Transactions.

TAXATION OF INTERNATIONAL TRANSACTIONS

There are only two areas of the White Paper proposals in respect of the taxation of international transactions which the Vancouver Board of Trade wishes to comment upon.

1. At paragraph 6.9, the White Paper acknowledges that Canadian business is often required to go abroad to seek foreign sources of supply and to develop foreign markets. Other advantages of investment abroad by Canadian entities are discussed in the same paragraph. The proposal which follows that paragraph would permit a flow-through of foreign tax to shareholders of Canadian companies to the extent of 15 percentage points of foreign tax suffered.

Such a proposal is somewhat at odds with the sentiments expressed in paragraph 6.9. This follows from the fact that the flow-through proposal is not as beneficial to Canadian shareholders of Canadian companies as the existing 20% dividend credit which would be repealed if the White Paper proposals were to be implemented.

Because this Board agrees with the comments set out in paragraph 6.9, it is recommended that if any change in the tax structure is to occur, it should be so arranged that the impact of Canadian tax should be as neutral as possible as between investment in Canada and investment abroad - provided that the act of investing abroad fell within a suitable business purpose test.

2. With respect to overseas operations which did not meet a business purpose test, the White Paper states in paragraph 6.21 that the government proposes to introduce provisions into the Canadian tax structure which would be patterned on certain measures introduced into the United States Internal Revenue Code in 1962 in order to combat so-called "tax-haven operations".

The particular measures in question are extraordinarily complex and have not worked overly well for the United States. Accordingly, it is disappointing that after years of study, the Canadian government could do no better than borrow rather shop-worn ideas from the United States.

The Canadian Department of National Revenue and Department of Finance

have tended in recent years to shout before they are hurt. There are a number of situations pointed to by the White Paper as representing serious tax avoidance problems which must be countered by new and sweeping tax changes. In almost all these cases, the Vancouver Board of Trade contends that the Department of National Revenue has either already got the situation under control or is capable of doing so by fully utilizing the tools at present available to it under the existing Income Tax Act. This Board considers that this problem would be no exception provided taxpayers were required to report more details pertaining to their overseas activities and investments.

Specifically, the Board suggests that with the assistance of increased reporting requirements, the Department of National Revenue would be in a position to contend that many companies which were incorporated in tax haven countries solely to avoid Canadian taxes were managed and controlled from Canada. Under such circumstances, the companies would be subject to tax in Canada under the present Income Tax Act at normal rates.

The Board also suggest that the proposed limitation (paragraph 6.15) of the tax exemption afforded to dividends received from overseas subsidiaries would create needless administrative burdens for both the government and the taxpayers and would yield only a small amount of revenue to the government. This Board recommends that the exemption referred to should be limited only by reference to a level of passive income accruing to the overseas company. This level might be fixed arbitrarily at 25% of total income.

The Board's recommendations in the two above areas have been set out in detail in a separate brief to the Tax Policy Unit of the Department of Finance (see the final section of this brief).

PART C - TECHNICAL DISCUSSION PAPERS

C O N T E N T S

1. Entertainment, Etc. Expenses
2. Subpart "F"
3. Foreign Tax Gross-Up and Credit
4. Thin Capitalization
5. Mining and Oil Industries
6. Tax on Transitional Spread
7. Consolidated Tax Returns
8. Tax Shelters
9. Cost Basis of Bequests, etc.

Technical Paper No. 1 - Entertainment, Etc. ExpensesA DISCUSSION OF THE PROPOSAL TO DISALLOW
ENTERTAINMENT AND RELATED EXPENDITURES

Paragraph 5.9 of the White Paper states in part that - "Consequently it is proposed that the Income Tax Act specifically deny deduction for entertainment expenses, the costs of attending or sending employees to conventions, and the cost of dues for membership in social or recreational clubs."

There is no need for such a proposal and its implementation would produce inequities.

In recent years, the Taxation Division of the Department of National Revenue has been successful in achieving a high degree of compliance and has received strong support from the Tax Appeal Board and higher courts. The Board of Trade recommends that there be no blanket disallowance of such expenditures, but in order to assist the Taxation Division in achieving an even greater degree of compliance, it is suggested that:

- (i) An additional subsection to Section 125 of the Income Tax Act be enacted which would require that certain defined expenditures be recorded in the taxpayers' financial records in separate accounts.
- (ii) An additional subsection to Section 56 of the Income Tax Act be enacted whereby a taxpayer who could not reasonably support in terms of business purpose and documentation a claimed deduction for entertainment expenses which was essentially similar to expenditures disallowed for Income Tax purposes in any prior year be subject to a penalty of, say, 25% of additional tax resulting from a disallowance of such items.

Technical Paper No. 2 - "Subpart F"A DISCUSSION OF THE PROPOSAL TO TAX PASSIVE INCOME OF
CONTROLLED FOREIGN CORPORATIONS BY THE INTRODUCTION
OF PROVISIONS SIMILAR TO SUB-PART F OF THE U.S. CODE

Paragraph 6.21 of the White Paper states -

"To counter this type of tax-haven abuse, the United States now provides that when such income is channelled to a controlled foreign corporation, the U.S. controlling shareholders shall be taxed on a current basis whether or not the income is distributed to them. U.S. taxes are levied in the year in which the profits are earned rather than postponed until the profits are returned home. The government proposes to introduce provisions patterned generally on those in the United States. This proposal involves complicated and difficult law, but the problem is serious and defies easy solution."

The Board feels very strongly that the complexities of legislation similar to "Subpart F" of the United States Internal Revenue Code should be avoided. "Subpart F" has not proved to be satisfactory in the United States. A simpler system would be preferable even at the risk and cost of leaving some tax abuses unresolved.

The following approach is recommended:

1. Dividends from Foreign Controlled Corporations in Treaty Countries

- (a) The treatment of dividends as exempt income under Section 28(1)(d) of the Income Tax Act should be conditional upon the filing of current audited financial statements of the foreign subsidiary.
- (b) If, say, 25% or more of the total income of the overseas corporation is "passive" income, then the election to treat the dividends as exempt income under Section 28(1)(d) would be forfeited in that year and the total income deemed to be distributed with full gross-up and tax credit. Actual distributions would be deemed to be paid first out of deemed distributions net of relevant foreign tax.

Diversion of passive income to treaty countries would be infrequent; diversion of such income would more likely be made to non-treaty countries.

2. Dividends from Foreign Controlled Corporations in Non-Treaty Countries

On all T1s, T2s and T3s, the following question should be asked:

"Do you, or together with members of your family, own directly or indirectly a 10% or more interest in any class of shares of a company incorporated in a country with which Canada does not have a tax treaty?"

(Countries with which Canada has a treaty should be listed in the information booklets or schedules issued with tax returns.)

If the answer to the above question was "yes", then regulations would provide that the Taxation Division of the Department of National Revenue may demand the filing of additional information relating to the location of management and control and the composition of the company's income.

If such information indicated that 25% or more of the income was "passive", the income would be deemed to be distributed with full gross-up and tax credit. Consideration should be given to a penalty on unpaid taxes resulting from non-compliance.

3. Definition of Passive Income

Passive income must be defined with care not only to prevent abuse through the use of tax havens but also to ensure that the international competitiveness of Canadians in genuine business is not hampered. The income source defined in Section 68(1)(b) of the Income Tax Act could be used. However, it is recommended that dividends from subsidiaries and sub-subsidiaries be treated as non-passive income if the income source of the dividend payment within the controlled group were non-passive income.

Instead of including unwarranted transshipment profits in a "passive" income definition, it is suggested that the present section 17 of the Income Tax Act be made more effective by promulgating Regulations similar to United States Income Tax Regulations 1.482 - 2 (b) and (c).

Technical Paper No. 3 - Foreign Tax Gross-up and CreditA DISCUSSION OF THE PROPOSAL TO ALLOW FULL GROSS-UP AND
CREDIT FOR DIVIDENDS FROM CANADIAN CONTROLLED FOREIGN
CORPORATIONS NOT INCORPORATED IN TAX TREATY COUNTRIES

Paragraph 6.17 of the White Paper states:

"A dividend from a Canadian controlled foreign corporation not protected by tax treaty would be subject to a tax credit regime. The Canadian corporation would be allowed a credit for the foreign withholding taxes imposed on the dividend and for any foreign corporate tax imposed on the underlying business profits from which the dividend was paid. This would reduce or eliminate taxes due on the dividend, which taxes would be computed on the dividend plus the tax for which credit was available."

If this proposal were to be implemented it is suggested that the following items, inter alia, be carefully defined:

- (i) Method of computing the foreign income for Canadian tax purposes.
- (ii) Method of computing foreign taxes for Canadian tax purposes.
- (iii) Extent to which, and manner in which, 2nd or 3rd tier foreign subsidiaries income and taxes should be taken into account.
- (iv) Method and extent of carry-over to other years of excess foreign taxes.

Technical Paper No. 4 - Thin Capitalization

A DISCUSSION OF THE PROPOSAL TO ADJUST THE
INTEREST DEDUCTION IN CANADIAN SUBSIDIARIES
THAT ARE THINLY CAPITALIZED

Paragraph 6.42 of the White Paper states in part that:

"The Government proposes to restrict the deductibility of non-arm's length interest wherever the ratio of shareholder debt to equity exceeds three to one."

The Board suggests that "equity" for this purpose be defined so as to include the retained earnings on hand at the beginning of each fiscal period. Furthermore, it is recommended that if a Canadian corporate borrower re-loans a portion of the borrowings to an associated company in Canada, that portion of the loan should be tested in the hands of the secondary borrower instead of in the hands of the initial Canadian borrower.

Technical Paper No. 5 - Mining and Oil IndustriesA DISCUSSION OF THE PROPOSALS AS THEY AFFECT
THE MINING AND OIL AND GAS INDUSTRIES

1. In accordance with the concept set out in the White Paper that taxpayers would not be taxed on mining ventures until after they have recovered their investment, it is recommended that the new depreciable class referred to in paragraph 5.29 of the White Paper include not only (g) and (k) of the present Class 10 of Schedule B of the Income Tax Regulations, but also roads, townsites, dams, tunnels, company utility service costs and any other capital costs of a similar nature required to phase the mine into production.
2. As open pit mining is becoming more commonplace we recommend that the cost of mineral properties should include the cost of surface rights.
3. Transactions which give rise to expenditures deductible under Section 83A of the Income Tax Act and which involve a transference of mineral properties or of shares in corporations should be regarded as tax-free re-organizations as far as any gain or loss on the transference of the properties or shares is concerned.
4. It should be made clear that the cost of mineral rights would be deductible under the proposals set out in paragraph 5.26 or, if the principal business test is met, under Section 83A of the Income Tax Act.
5. The Board recommends that the unused portion of any eligible expenditures for the purpose of claiming depletion allowance be transferable upon or in respect of:
 - (i) A statutory amalgamation.
 - (ii) A renouncement of exploration costs by a joint exploration company.
 - (iii) A joint venture or partnership operation.
 - (iv) A consolidation of tax returns.
6. Because of the potential advantage to the Canadian economy and the extremely limited source for tax revenues, it is recommended that the exemption to prospectors under Section 83(2) remain in the Income Tax Act. It should not be overlooked that many major mines in Canada today were discovered initially by independent individual prospectors.

Technical Paper No. 6 - Tax on Transitional Spread

A DISCUSSION OF THE PROPOSAL TO INTRODUCE TRANSITIONAL
PROVISIONS WHICH WILL REDUCE THE USE OF CREDITABLE TAX
FOR CERTAIN CLOSELY-HELD CORPORATIONS

Paragraph 4.79 of the White Paper states:

"To secure tax on the recapturable depreciation, it is proposed that part of the tax paid by closely-held corporations be treated as non-creditable until non-creditable tax has been collected on the amount that would have been taxable under the present system. This would of course not accomplish the objective with respect to corporations that are to be treated as partnerships. Shareholders of such corporations would have to elect to value their shares in the same manner as a proprietor or partner is to value his business assets - at values that would leave inventory profits and recapturable depreciation taxable."

The Board recognizes the necessity for restricting the flow-through of creditable tax that would otherwise occur on the payment by closely-held corporations of tax on recaptured capital cost allowance applicable to capital cost allowance taken prior to implementation day. There is also the necessity for making similar adjustments for goodwill and inventory profits existing at implementation day.

The system proposed to control the flow-through of creditable tax called "the tax on the transitional spread" but better known as the "ransom pouch" is unacceptable for the following reasons:

- (i) It is too complex.
- (ii) All closely-held corporations which have not elected under the partnership option will have to be valued on two bases soon after implementation day in order to establish the amount of creditable tax available for dividends.
- (iii) It will restrict the payment of dividends by reducing the amount of creditable tax that is available in the earlier years. This measure will thus create horizontal inequity as between such a company and the shareholders of such a company and the shareholders of other closely-held corporations that are in a position to elect under the partnership option.
- (iv) An overriding inequity arises from the fact that the shareholders of the companies involved would, in varying degrees, depending on

the circumstances, be taxed in advance of their companies' entering into the sales of goodwill or depreciable assets which represent the taxable transactions in question. In fact, in many instances the procedure would represent a taxation of transactions which might never take place.

The Vancouver Board of Trade recommends:

- (i) That the ransom pouch proposal as envisaged by paragraph 4.79 be abandoned.
- (ii) That a closely-held company be valued as of "Valuation Day" on two bases - i.e., a value of the shares at fair market value which will include goodwill, and a tax value basis. Other things being equal, these valuations would not then need to be made until a sale of goodwill, etc. took place.
- (iii) That any tax paid on recapture or sale of goodwill would be diverted at that time from the creditable tax pool to the ransom pouch.
- (iv) That in any case where the fair market value of inventories on hand on Valuation Day represented an identifiable element in the computation of the valuation of the company's shares, the 4.79 plan would apply.
- (v) That to avoid detailed segregation of assets acquired pre- and post-"Implementation Day", it would be assumed that any tax on recapture would apply first against the ransom pouch.
- (vi) That the Valuation Day fair market value of the shares would be reduced by the amount of any tax applied against the ransom pouch.

Under paragraph 3.49 of the White Paper, it is suggested that, in most instances, a corporation on winding up would be deemed to sell its assets to the shareholders for a price equal to the cost basis of their shares. Under such a concept, a person purchasing shares of a company having a transitional spread would trigger a diversion of tax to the ransom pouch if he caused the company to liquidate in order to step up the bases of the assets underlying his share acquisition.

Accordingly, it is suggested that no adjustment with respect to transitional spread would be required upon the sale of shares because the price would reflect - at least to some degree¹ - the amount of any transitional spread because such would represent a contingent tax liability.

1. Caveat emptor.

Technical Paper No. 7 - Consolidated Tax ReturnsA DISCUSSION WITH RESPECT TO THE FILING
OF CONSOLIDATED CORPORATION TAX RETURNS

The government evidently considers that its proposal whereby a corporation can be treated as a partnership would permit groups of corporations to achieve the same result as they would obtain under a permission to file consolidated tax returns. The government does not propose, therefore, to provide for consolidated returns as such.

The Board is concerned that the partnership election concept will create horizontal inequity in that a taxpayer able to elect who competes against a taxpayer unable to do so may have an advantage.

It is suggested that the filing of returns on a consolidated basis be available to all groups of associated companies. As a minimum it is recommended that the partnership election test relating to one class of shares be inapplicable to wholly-owned subsidiaries.

Technical Paper No. 8 - Tax Shelters

A DISCUSSION OF THE PROPOSAL TO ELIMINATE
THE USE OF TAX SHELTERS AS PROPOSED IN
PARAGRAPH 5.17 OF THE WHITE PAPER

The main purpose of the proposal set out in paragraph 5.17 is to prevent the application of tax losses resulting from holding property against other income sources. In particular, it seeks to remove the advantage obtainable at present by high income earning individuals.

The Board is concerned that in eliminating this practice, the law might be drafted too broadly and be detrimental to bona fide businesses.

In order to prevent this happening, the proposal should not apply to:

- (i) property the rental of which represents the principal occupation of the taxpayer, or to
- (ii) property of the taxpayer which is used to a significant extent by lessees in the production, finishing, packaging or marketing of products or services of the taxpayer.
- (iii) property used with respect to the housing and/or the provision of shopping and/or recreational activities of employees of the taxpayer provided such employees are not related to the taxpayer or to any shareholder or group of shareholders who control a corporate taxpayer.

Alternatively, the application of the proposal should be restricted to individuals. Under such an approach it would be necessary to prohibit the use of the partnership election by individual shareholders of corporations incurring tax losses created by depreciation.

Technical Paper No. 9 - Cost Basis of Bequests, etc.

A DISCUSSION OF THE PROPOSAL RELATING
TO THE COST BASIS OF BEQUESTS

Paragraph 3.42 of the White Paper states:

"To avoid this situation, the government proposes that capital gains not be accrued at the time of death but that the person who inherits the assets be treated as if he had purchased them at their cost to the deceased."

Such a rule would be equitable for property purchased by the deceased after "Implementation Day". Property acquired prior to this time should be treated as if the beneficiary had made the purchase at "Valuation Day" value. Otherwise there would be taxation of pre-Implementation Day capital gains. In other words, the term "cost" as used in paragraph 3.42 (and also in paragraph 3.24) of the White Paper should - if the proposals are enacted - be defined so as to mean cost basis or tax basis.



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Second Session—Twenty-eighth Parliament
1969-70

THE SENATE OF CANADA
PROCEEDINGS
OF THE
STANDING SENATE COMMITTEE
ON
BANKING, TRADE AND COMMERCE

The Honourable **SALTER A. HAYDEN**, *Chairman*

No. 33

TUESDAY, JUNE 16, 1970

*Twenty-Seventh Proceedings on the Government White Paper,
entitled:*

"PROPOSALS FOR TAX REFORM"

WITNESSES:

(For list of witnesses see Minutes of Proceedings—Page 33 : 5)

APPENDICES:

"A"—Brief from Sun Oil Company Limited.

"B"—Brief from Great Canadian Oil Sands Limited.

THE STANDING SENATE COMMITTEE ON
BANKING, TRADE AND COMMERCE

The Honourable Salter A. Hayden, *Chairman*

The Honourable Senators:

Aird	Desruisseaux	Kinley
Aseltine	Everett	Lang
Beaubien	Gélinas	Macnaughton
Benidickson	Giguère	Molson
Blois	Grosart	Phillips (<i>Rigaud</i>)
Burchill	Haig	Walker
Carter	Hayden	Welch
Choquette	Hays	White
Connolly (<i>Ottawa West</i>)	Hollett	Willis—(30)
Cook	Isnor	
Croll		

Ex officio members: Flynn and Martin

(Quorum 7)

ORDERS OF REFERENCE

Extract from the Minutes of the Proceedings of the Senate, November 19, 1969:

“With leave of the Senate,
The Honourable Senator Martin, P.C., moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on Banking, Trade and Commerce be authorized to examine and report upon the White Paper intitled: “Proposals for Tax Reform”, prepared by the Minister of Finance, and tabled in the Senate on Tuesday, 18th November, 1969.

After debate, and—

The question being put on the motion, it was—
Resolved in the affirmative.”

Extract from the Minutes of the Proceedings of the Senate, December 19, 1969:

“With leave of the Senate,
The Honourable Senator Phillips (*Rigaud*), moved, seconded by the Honourable Senator Robichaud, P.C.:

That the Standing Senate Committee on Banking, Trade and Commerce be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—

The question being put on the motion, it was—
Resolved in the affirmative.”

Extract from the Minutes of the Proceedings of the Senate, February 18, 1970:

“With leave of the Senate,
The Honourable Senator McDonald moved, seconded by the Honourable Senator Hayden:

That the Standing Senate Committee on Banking, Trade and Commerce have power to sit during adjournments of the Senate.

After debate, and—

The question being put on the motion, it was—
Resolved in the affirmative.”

ROBERT FORTIER,
Clerk of the Senate.

MINUTES OF PROCEEDINGS

TUESDAY, June 16th, 1970.

(53)

Pursuant to adjournment and notice the Standing Senate Committee on Banking, Trade and Commerce met this day at 8:00 p.m. to further consider:

The Government White Paper entitled: "Proposals for Tax Reform".

Present: The Honourable Senators Hayden (*Chairman*), Aird, Aseltine, Beaubien, Benidickson, Blois, Burchill, Carter, Connolly (*Ottawa West*), Cook, Desruisseaux, Gelinas, Hollett, Isnor, Molson, Phillips (*Rigaud*), Welch and Willis (18).

Present, but not of the Committee: The Honourable Senator Hastings—(1).

In attendance: Roland B. Breton, Executive Secretary.

WITNESSES:

*Sun Oil Company Limited &
Great Canadian Oil Sands Limited:*

Mr. K. F. Heddon, President, Sun Oil Co. Ltd., and Great Canadian Oil Sands Ltd.;

Mr. W. H. Rea, Chairman of the Board, Great Canadian Oil Sands Limited;

Mr. A. S. Kingsmill, Counsel to Sun Oil Co. Ltd., and Secretary to Great Canadian Oil Sands Limited.

Ordered:—That the documents submitted at the meeting today be printed as appendices to these proceedings, as follows:

A—Brief from Sun Oil Company Limited.

B—Brief from Great Canadian Oil Sands Limited.

At 9:30 p.m. the Committee adjourned until Wednesday, June 17th, 1970 at 9:00 a.m.

ATTEST:

Frank A. Jackson,
Clerk of the Committee.

THE SENATE STANDING COMMITTEE ON BANKING,

TRADE AND COMMERCE

EVIDENCE

Ottawa, Tuesday, June 16, 1970

The Standing Senate Committee on Banking, Trade and Commerce met this day at 8.15 p.m. to give further consideration to the White Paper entitled "Proposals for Tax Reform".

Hon. Salter A. Hayden (Chairman) in the Chair.

The Chairman: Honourable senators, may I call the meeting to order. We have two submissions tonight; one from Sun Oil Company Limited and the other from Great Canadian Oil Sands Limited, and Mr. Heddon, who is the president of both companies, is going to make the opening statement.

Will you make the opening statement and also introduce your panel?

Mr. K. F. Heddon, President, Sun Oil Company Limited and Great Canadian Oil Sands Limited: Thank you, Senator Hayden, and good evening, gentlemen. I am K. F. Heddon, president of Sun Oil Company Limited and also Great Canadian Oil Sands Limited. On my immediate right is Mr. W. H. Rea, who is Chairman of the Board of Great Canadian Oil Sands Limited and on his right is Mr. A. S. Kingsmill, counsel for Sun Oil Company Limited and Secretary of Great Canadian Oil Sands Limited.

First of all, I think that quite possibly a word of thanks is due to you gentlemen for holding this special session. I understand this is one of the few, if not the only, evening meetings which you have held and we do appreciate your attendance.

We propose to discuss the Sun submission first and on completion of that discussion we will then discuss Great Canadian Oil Sands submission.

We welcome the opportunity of appearing before your Committee this evening to present our views and to discuss the White Paper Proposals on Tax Reform. Sun Oil Company

Limited's submission to your Committee will be very brief. I will quickly restate the major points in Sun's submission as set forth in the summary, but will be pleased to answer your questions at any time. I am reading now just from the summary:

It is Sun's objective to integrate the exploration and production operations of the Canadian branch of the U.S. parent company with the refining and marketing operations of the Canadian company and to issue shares of the integrated company to the Canadian public. It is therefore the purpose of this brief to deal primarily with those tax matters which would impede Sun's goal of integration and on which Sun believes it can make a valuable contribution toward achieving the goal of reasonable tax reform. Accordingly, Sun makes the following proposals:

(1) **Exploration and Development Costs:** Sun proposes a tax-free 'roll-over' of oil and gas rights and related exploration and development expenditures between associated companies.

(2) **Depletion:** Sun agrees with previous submissions that Canadian depletion allowance should be based on gross production income and be at a rate similar to that in the United States.

(3) **Creditable Tax:** Sun proposes that there be a deemed creditable tax so that tax incentives such as depletion are not largely eliminated when the corporation's earnings are distributed to shareholders.

(4) **Quinquennial Revaluation:** Sun proposes that quinquennial revaluation not be enacted as it would discourage Sun from having the Canadian company issue shares to the Canadian public.

In addition to the above proposals, Sun has made comments on certain other aspects of the White Paper which, for the purposes of brevity, and because of the fact that these comments do not relate directly to Sun's objective of integration, are not repeated here.

You will of course find that in the body of the submission. That is the end of my comments.

The Chairman: Now we are ready for questions.

Senator Phillips (Rigaud): Mr. Chairman, may I put a question? I am not too clear what you mean by roll-over of the associated companies.

Mr. Heddon: We have with us this evening, senator, Mr. Kingsmill, our counsel, and I am going to ask him to explain that to you.

Senator Phillips (Rigaud): Before he does so, I would like to ask the Chairman whether this is the first time in memory that this point has been before us.

The Chairman: I do not recollect it.

Senator Phillips (Rigaud): It is the first time.

Senator Beaubien: On roll-over?

The Chairman: Will you explain how roll-over takes place? Is it something like dividends going out through a number of companies?

Mr. A. S. Kingsmill, Counsel, Sun Oil Company Limited; Secretary, Great Canadian Oil Sands Limited: By way of explanation, Mr. Chairman, the Sun brief is prepared to deal with the tax problems which are standing in the way of Sun achieving the goal of an integrated company in Canada.

At the moment Sun's operations in Canada are divided into two segments. There is Sun Oil Company Limited, which is a Canadian company, and it operates service stations and refineries in Ontario and in the Province of Quebec, and also conducts exploration and development operations in Western Canada.

Sun Oil Company of the United States operates a Calgary branch and the Calgary branch, too, engages in exploration and development operations in Western Canada and also in the Northwest Territories of Canada. In order to bring integration about we want to merge these two operations, the Calgary branch of the United States company with the assets of the Canadian company and a provision of the present tax laws stands in the road of this proposal.

In order to bring integration about the Canadian company would purchase oil and gas rights of its parent. Those are oil and gas

rights held by the Calgary branch. Under the present tax law the proceeds of disposition received by the parent, upon transfer of its oil and gas rights to the Canadian subsidiary, would be included and computed in its income for Canadian tax purposes. As pointed out in the brief this would result in a tax cost to the U.S. parent company of some fifteen million dollars.

Now, the Sun submission is that the tax system should not stand in the road of such integration and that there should be some way whereby these assets could be merely rolled over, a roll-over from the Calgary branch to the Canadian company without attracting any taxes so that you would have a shift and the assets would go onto the books of the Canadian company at the same tax cost as they are presently on the books of the U.S.A. company, Calgary branch.

Senator Phillips (Rigaud): Are you speaking of the present tax laws or are you speaking of the proposed law under the White Paper?

Mr. Kingsmill: I am speaking of the present law.

Senator Phillips (Rigaud): Because it is hardly a submission that comes within the jurisdiction of this committee.

The Chairman: No.

Mr. Kingsmill: The White Paper does discuss roll-over in respect of transfers between associated companies and really I think the submission here is that it would be desirable if this principle were extended to include a transfer such as we have outlined.

The Chairman: What would your position be if you incorporated in Canada the branch operations of the U.S. company?

Mr. Kingsmill: Then again we would have the same problem, I believe, at integration.

The Chairman: No. At that stage if you had a Canadian company it would have to buy its assets from the U.S. company.

Mr. Kingsmill: That is correct, yes. So I think we would have the same problem, Mr. Chairman.

The Chairman: What is the Canadian company, Sun Oil Company Limited; is that a federally or provincially-incorporated company?

Mr. Kingsmill: It is a federally-incorporated company.

Senator Connolly: Letters patent.

Mr. Kingsmill: Yes.

Senator Phillips (Rigaud): And the American company operates an alternative—

Mr. Kingsmill: That is correct.

Senator Phillips (Rigaud): And that includes a treaty set up for tax credits?

Mr. Kingsmill: Exactly correct.

Senator Phillips (Rigaud): Thanks very much. I at least understand it now.

Senator Cook: Would the parent company transfer these assets to the Canadian company at cost or would there be any profit involved?

Mr. Kingsmill: Well, I would think under the existing tax law it would be required to transfer at fair market value.

The Chairman: That is right.

Senator Cook: Would that fair market value involve any profit?

Mr. Kingsmill: Yes.

Senator Cook: Still you want to suggest roll-over which would have the advantage of the tax benefit?

Mr. Kingsmill: Yes. Roll-over would eliminate the profit. If you have roll-over then the transfer would take place at original cost and you would eliminate profit thereby eliminating the tax in respect of the transfer between one interest to really another part of the same interest.

The Chairman: Well, the branch operations are now paying Canadian tax on their operations unless they have enough deductions.

Mr. Kingsmill: That is correct.

The Chairman: And then they pay withholding tax whether they remit any money to the U.S. or not?

Mr. Kingsmill: Yes; the withholding tax they pay being the special 15 per cent tax.

The Chairman: That is right.

Mr. Kingsmill: Receivable in respect of a profit of a branch operation in Canada.

The Chairman: You have explored the situation and you can find no way of getting these assets into the Canadian company without creating a profit problem and therefore a tax problem.

Mr. Kingsmill: I think that is generally true, yes.

The Chairman: Well, I suppose to some extent you could pay dividends.

Senator Beaubien: To the parent company?

The Chairman: I beg your pardon?

Senator Beaubien: Pay a dividend to the parent company?

The Chairman: Well, not a quasi-dividend. It is only a private operation so it is only the American company carrying on in Canada so it cannot pay a dividend to itself but it could transfer profits after it had paid Canadian tax at the special rate.

Mr. Kingsmill: Yes, but the difficulty being, though, that the transfer of the oil and gas rights from the branch to the Canadian company itself is a thing that creates the problem.

The Chairman: Well, you have got yourself a problem. We do not know whether we can help you or not but we will have a good look at it. It does not appear to be within the scope of the White Paper but I do not know, in the overall view of the oil and gas proposals in the White Paper, there may be something. This is the first time I have seen this sort of situation.

Senator Connolly: Mr. Chairman, I think this has happened before with other American medias coming into Canada, has it not?

Mr. Kingsmill: I think we get the same situation with other American medias coming into Canada. I think in many cases the branch assets were transferred to the Canadian subsidiary prior to the enactment of the present Section 83A whereby the proceeds of disposition of oil and gas rights are automatically included in income for tax purposes.

Senator Cook: This is a problem irrespective of the White Paper.

The Chairman: No, this is the problem which exists independently.

Senator Carter: Under the present tax system.

The Chairman: Yes.

Senator Phillips (Rigaud): This is why it should be determined whether it is jurisdictional or not.

The Chairman: Well, this is something we will have to settle but I think we know what your point is. I do not know if we can help you but we can have a look at it.

Now we get to the question of depletion. The White Paper proposes what they call an earned depletion on the basis of you get a dollar for spending three dollars. What you have at the present time is a $33\frac{1}{3}$ reduction in your net production income, whether you spend any money on exploration and development or not. Is that correct?

Mr. Kingsmill: Yes, Mr. Chairman.

The Chairman: Well, now, there is a big gap between those two positions and can you live with the earned depletion proposal in the White Paper?

Mr. Kingsmill: I think the question becomes a very difficult one. Certainly at the moment it is true with the Sun Oil Company that their expenditures on exploration and development far exceed their profits. As a matter of fact, they have yet to derive any profits when you consider the deductions which are open to them.

The Chairman: So they have not been able to realize on the $33\frac{1}{3}$ per cent?

Mr. Kingsmill: That is right. But I would think, in looking at the White Paper, the White Paper, of course, cuts down the depletion which would be available to oil and gas companies in Canada.

I think that the Sun's position is that if growth is to be encouraged in Canada for oil and gas companies, what really must be considered is the rate of return for extractive operations in Canada as compared with the rate of return on investments in explorations in other parts of the world.

The Chairman: But the White Paper does propose a loss carried forward.

Mr. Kingsmill: For earned depletion.

The Chairman: For earned depletion.

Mr. Kingsmill: Yes, but the proposal for depletion in the White Paper, I think it is right to say, would be less advantageous than the law for depletion which is available in the United States.

The Chairman: Under the Income Tax Act, reverting to your problem that we discussed earlier, the proceeds of the sale of these oils, et cetera, whatever rights you have...

Mr. Kingsmill: The oil and gas rights.

The Chairman: ...would be treated as income.

Mr. Kingsmill: Yes.

The Chairman: And if there is a profit it would be taxable?

Mr. Kingsmill: That is right.

The Chairman: Well, it looks like as though you may have to create some losses for yourself or some write-offs.

Senator Connolly: Would it be fair to ask the witness, Mr. Chairman, first of all, how long Sun has been in Canada?

The Chairman: 1919, I think.

Mr. Heddon: The Sun Oil Company has been operating in Canada since 1919. The Sun Oil Company Limited has been incorporated in Canada since about 1923 and Sun Oil Company, Calgary division, has been operating in the production end of the business since the 1940's.

Senator Connolly: Have you any idea of the amount of money that you have expended in this country through any of these companies in exploring for oil and gas? Could you give us the total amount, and if you have not got the figures could you give us the approximate amount?

Mr. Heddon: I think there is a figure in the preamble, Mr. Kingsmill, is there not?

The approximate gross investment in exploration and development activity over the past 20-odd years is in excess of \$150 million.

Senator Connolly: Over what period, again, sir?

Mr. Heddon: Approximately 20 years since the mid-1940's.

Senator Connolly: A hundred and fifty million dollars.

Senator Benidickson: Those are the expenditures of the American branch and your Canadian-incorporated company combined?

Mr. Heddon: Yes, sir.

The Chairman: Well, very concisely then on the question of depletion your position is that you would prefer to carry on with the present depletion but to have it calculated on gross production income rather than net production income and you would take a cutback on that because the American rate is 27%; is that correct?

Mr. Kingsmill: I believe, Mr. Chairman, under the 1969 Tax Reform Act in the United States they have reduced the United States depletion from 27½ down to 22 per cent.

The Chairman: So if we take your proposal here literally you would be satisfied with a depletion allowance of 22% calculated on gross production income?

Mr. Kingsmill: That is the position, yes, sir.

Senator Connolly: You are talking about unearned depletion?

The Chairman: Rather than unearned depletion?

Senator Connolly: Rather than earned depletion.

Mr. Kingsmill: Yes.

The Chairman: We had a suggestion from Gulf that the depletion should be divided because there are some companies that cannot earn depletion. They suggested a 20% depletion, whether you earned it or not, calculated on gross production income and then earned depletion on the basis of a dollar for every two dollars spent. Have you any comment on that?

Mr. Kingsmill: I do not believe we really do, Mr. Chairman.

The Chairman: I think I suggested in the course of questioning that it might well be that this formula would produce about the same result as the 33⅓%. I think there was an indication that was right.

Mr. Kingsmill: Yes.

The Chairman: But it would take care of two kinds of cases.

Mr. Kingsmill: Yes, indeed it would.

The Chairman: It would take care of those that cannot earn depletion and therefore cannot get any benefit.

Mr. Kingsmill: Right.

Senator Connolly: Your position really is that you were spending so much money on exploration you cannot take advantage of the unearned depletion arrangements in the Tax Act now.

The Chairman: No. You cannot carry it forward.

Mr. Kingsmill: That is right.

Senator Connolly: So you have not had the advantage of it at all?

Mr. Kingsmill: That is correct.

Senator Connolly: But you look down the road apiece to the day when perhaps your exploration cost will not be as high as your profits and at that time you would hope for the unearned depletion?

Mr. Kingsmill: Yes.

The Chairman: Well, while you have not been able to take depletion, I take it you have earned money to pay for the exploration and development that you have done or has it been capital that has been raised?

Mr. Kingsmill: I think to a very large extent it has been capital that has been invested by the United States company in exploration operations in Canada.

Senator Cook: To what extent?

Mr. Kingsmill: Now, I do not have a figure on that.

Mr. Heddon: I am sorry; I do not know that figure either.

Senator Cook: It is an important figure when you say you have spent \$150 million in 20 years. What size asset has that \$150 million created?

Mr. Heddon: Sir?

Senator Cook: I say you spent \$150 million almost in 20 years in exploitation and development. I assumed that is not lost. What size asset has it created?

Mr. Heddon: Reserves of about eighty-five million barrels of oil and 340 million cubic feet of gas.

Senator Cook: Worth approximately how much?

Mr. Heddon: I would be pleased to try and develop that information and get it for you.

The Chairman: Will you send it in as quickly as you can?

Senator Cook: Is it worth more than \$150 million?

Mr. Heddon: I think that is a pretty hard question to answer right now. It depends on the type of crude and a number of factors.

The Chairman: Are there any other questions on depletion? If not, we can move on.

Senator Phillips (Rigaud): Yes, I would like to ask a question. Some suggestions have been made that depletion allowances, whether related to gross or net we will leave aside for the moment, should have a time limit in terms of tenure. Have you any thoughts on that point and would you like to express an opinion?

The general feeling is that in certain cases, that an indefinite allowance for depletion creates inequities insofar as other segments of the population are concerned and if given continuously brings about unfair results and excessive incentives to the oil industry, after admitting that incentives are required and should be given.

Mr. Kingsmill: By way of tenure, I take it the suggestion being that depletion allowances in respect of the particular asset would only be available for a particular time after the asset had been acquired?

Senator Phillips (Rigaud): That is right.

Mr. Kingsmill: I would only have this comment; that in committing exploration dollars, tax incentives play a very material part and the unlimited tenure of depletion, of course, gives rise to the larger potential benefit and that being so, I think that it would obviously encourage the expenditure of the oil and exploration dollar.

It depends on what we want. Do we want companies to spend money in finding resources? That being so, then presumably the tax system should be designed to provide encouragement for that expenditure. A qualified depletion, as far as tenure is concerned, is a better tax incentive, I think, than one related to tenure.

Senator Phillips (Rigaud): But the present incentives under the law indicate that particular incentives should be given or are being given. The White Paper also admits that incentives are necessary...

Mr. Kingsmill: Yes.

Senator Phillips (Rigaud): ...to bring about the objective to which you have just referred. It still leaves the question as to whether the degree of incentives by way of tenure is excessive at the present time, and as to whether it would not be fairer for the industry to accept some time limit because there is considerable reaction.

That is why we are here considering the problem because the benefits have been given and when at a given moment it is pretty clear that it is a clear tax concession of 100 per cent that is not related to opening up of new resources or not related to the development expenses and that sort of thing; nor is it clear that the concession, after given, is needed in order for an oil company to carry on in its business, earning millions of dollars.

Senator Beaubien: Mr. Kingsmill, before you answer that, what is done in the United States? Does the 20 per cent gross go on forever?

The Chairman: Twenty-two per cent of gross.

Senator Beaubien: Goes on forever.

Senator Birchall: It is open-end.

Senator Beaubien: And that is our chief competitor.

Mr. Kingsmill: Yes. As I understand it, in the United States the depletion allowance, which they have settled upon after extensive hearings before the United States Congress and so forth, the new depletion allowance is taken on the per-property basis and it is the lesser of 22 per cent of the gross production income from the property as long as the property produces or 50 per cent of the taxable income from the property.

You take the lesser amount but you do have depletion which is unqualified as to length of time it is available. The only thing that qualifies it is the development or exploitation of the particular property.

The Chairman: It is qualified if you stop operating.

Mr. Kingsmill: Yes.

Senator Beaubien: You would get no revenue.

Mr. Kingsmill: You would get no revenue so there is no depletion. It is pretty well qualified.

The Chairman: That is right.

Senator Connolly: Mr. Chairman, I wonder if I could ask the witness this? There are really two aspects to this question of depletion: one is the incentive aspect which is designed to encourage, you will agree, more exploration.

Mr. Kingsmill: Yes, I would agree.

Senator Connolly: In addition to that there is the element of competition. Perhaps I could explain that by saying this. In a given year you can only produce so much content of oil or gas and you still have to remain competitive on the world market with that product.

The Chairman: It is really the U.S. market, is it not?

Senator Connolly: Well, restrict it to the U.S. market, if you will, because I think that is the main market for Canada, but you never know. You might be selling to other countries some day tremendous quantities, perhaps even Northwest Europe.

Well, that being the case, suppose the depletion is cut off after a period of, let us say, 20 years. Then your tax rate is going to increase. Would you say there might be a possibility of your selling price being noncompetitive as the result of elimination of the depletion after a certain period?

Mr. Heddon: I am going to answer this in possibly a rather roundabout way, Senator Connolly. More than likely long prior to the 20-year period the problem of the lower incentive is going to back money out of Canada and put expenditures of those dollars into the United States or into Alaska or the Mideast because, whether it happens to be the Calgary production division of Sun Oil Company or the Sun Oil Company Limited, Canada competes for funds, as you mentioned previously I believe, in the world market. And if the rate of return is not as good an investment in Canada then it is almost impossible to get a share of these funds. They are diverted elsewhere. They may be diverted to Alaska. They may be diverted to the Middle East or many other places. Frankly...

The Chairman: If you will stop there. Can you tell me in how many years in the last five years have taken the existing type of depletion?

Mr. Heddon: We would not have taken depletion in any year in the past five.

The Chairman: You would not have, so it has not been of any benefit to you.

Mr. Heddon: That is correct.

The Chairman: You have been able to compete with your crude in the United States where they have these depletion allowances notwithstanding the fact that you cannot use it.

Mr. Heddon: As far as the selling price of crude is concerned, yes, but it affects us very greatly in the number of dollars we can put into Canada to develop new crude.

The Chairman: On the basis that hope springs eternal?

Mr. Heddon: I guess that is right.

Senator Phillips (Rigaud): Mr. Chairman, may I ask a question?

The Chairman: Yes, senator.

Senator Phillips (Rigaud): My position has been pretty clear before in dealing with this question, and I am in favour of incentives, and the issue is the degree of the incentive. It is not accepted in certain circles that capital will flow on an international basis because the question of an investment in the Near East or even in South American countries or that sort of thing creates political and other problems. Therefore there is resistance to the general concept that the industry in Canada is entitled to relief by way of major incentives on the theory that if Canada does not grant it, international money will flow in other directions. It may flow on a lesser basis between Canada and the United States.

I am not one of the spokesmen for those who say that in the sense of "Believe it or not." I am really indicating to you this resistance against your observations. The position I am putting to you is that—I think that the Chairman has a fantastic memory in this respect—I think one of the other major oil companies did say they could live with a 21-year depletion tenure.

The Chairman: Yes.

Senator Phillips (Rigaud): Without mentioning the name of the company. I am trying to find out from a company of your stature as to whether it would be disastrous or very serious indeed if this Committee recommended a

limit to depletion; in other words, we are speaking to you representing an important company in Canada. Would we be making a grievous error and seriously affecting the industry if we came to such a conclusion?

Senator Cook: Everybody would have to pay more taxes.

Senator Beaubien: This is after 21 years.

Senator Connolly: This is only after 21 years.

Senator Phillips (Rigaud): After 21 years. I am speaking of a tenure of twenty or twenty-one years.

The Chairman: Senator Cook and Senator Beaubien, you are making an assumption, and that is, one, the company has to earn money or you can forget about depletion at all. Now, the company has not used the depletion that is available so far because it has not earned....

Senator Beaubien: Since 1919.

The Chairman: I just put it in the last five years.

Senator Beaubien: Well, it started in 1919.

Mr. Heddon: We have been in production, sir, since about the mid-1940's.

The Chairman: Now, when you start talking about tax problems, if there are earnings you can take advantage of depletion. The tax, of course, would only apply to what was left after depletion had been taken but it would be the full rate of tax. I think that is the real definition of an incentive. It differs from a subsidy because an incentive is something that is designed to subject you to less tax than you may otherwise be subjected to.

Senator Beaubien: On this same subject, Mr. Heddon, how many wells are there that would produce for 21 years on end? Are there any or many?

Mr. Heddon: I am sure there are some, sir. I could not give you a final answer on that.

Senator Beaubien: Does it happen? Does an ordinary well produce for an awfully long time, if it comes in?

Mr. Heddon: Usually.

Senator Beaubien: Twenty-one years?

Mr. Heddon: Yes. I would say that as a general statement and I am sure there are lots of exceptions to that.

Senator Connolly: Your production could very well be regulated, too? It could be regulated by the Provincial Conservation Boards, too.

Mr. Heddon: Yes, this is correct.

Senator Connolly: So a field that perhaps could be normally produced completely in a period of ten years may be phased out over a period of 35 years by order of a Conservation Board.

Mr. Heddon: And then it may water-clog and you get a brand-new problem.

Senator Connolly: I am concerned about the question that Senator Phillips (Rigaud) has been putting to you because frankly I have this difficulty.

If your depletion had a time limit placed upon it, surely after that time limit has expired then your product, your oil or your gas, will be sold at a price that is higher than it was sold before the time it did expire and it might well be non-competitive.

Mr. Heddon: Or I guess you could put it another way. If you are going to sell it at all you have to sell on a competitive basis or people are unlikely to buy it and the profit therefrom could be such that it would be uninteresting to invest money.

Senator Connolly: If you start on the premise, as the Chairman did, that your principal market is in the United States, then surely you reduce it to a very simple proposition; that as far as possible that our unearned depletion allowance here should be on par with theirs if we are to be competitive and they are open-end.

Mr. Heddon: And this is our proposal, sir.

The Chairman: Now, of course, to follow that through, Senator Connolly, I pointed out a few minutes ago in the United States their present depletion laws are 22 per cent calculated on gross production income and in Canada they are 33½ per cent of net production income.

Now, notwithstanding that situation, this Canadian company has competed. Undoubtedly its profit has been less and its profit has been so much less that it has not been able to take advantage of the depletion allowance so

it has been competing with oil in the United States which, I assume, enjoys a depletion allowance and it has not earned enough to be able to take advantage of the depletion allowance.

Mr. Heddon: Yes.

Senator Beaubien: No depletion allowance?

The Chairman: No; no depletion allowance.

Senator Beaubien: Has not Sun taken any depletion whatsoever?

The Chairman: No. Remember...

Senator Benidickson: Because of other deductions.

The Chairman: Yes. Because, first of all, the cost of sinking the wells, et cetera, and other operating costs.

Senator Benidickson: Writing that off.

Senator Connolly: In other words, they are spending more on exploration than they are taking in by way of income.

Mr. Kingsmill: This is correct.

Mr. Heddon: I think as a matter of interest Sun Oil Company has never returned a cent to Sun Oil Company. Every dollar which has been generated by Sun Limited has been left in Canada for development.

The Chairman: Then what you are telling us is what would be the ideal depletion allowance for you, even though you have not enjoyed it yet.

Mr. Kingsmill: Yes. I might add, Mr. Chairman, the major production of assets of the Sun Oil overall enterprise are in the Calgary branch. That, of course, is the United States company.

While the United States company does not enjoy any Canadian depletion because the Canadian depletion at the moment is related to one-third of profits, it does, of course, enjoy United States depletion because of its income from its Canadian assets.

The Chairman: That is right.

Mr. Heddon: Mr. Kingsmill, this would be another bar against integration.

Mr. Kingsmill: Yes. That is a further impediment to integration because the United States depletion allowance to the extent that

it is based on gross production income, as distinct from productivity, is more generous than the Canadian allowance.

The Chairman: Are there any more questions?

Senator Carter: Yes, I have something, Mr. Chairman. What advantages would integration give you to offset the additional taxation which you have mentioned?

Mr. Heddon: I think the integration of Sun Oil Company's operations with Sun Limited is well in line with the philosophy expressed by the Canadian Government. With an integrated company then we would hope to go public. Without having an integrated company we really do not expect to be able to generate enough funds over the years and to have a sufficiently broad base to go public. I think there are some advantages in having a public company both to the Canadian public and to Sun Oil Company Limited.

The Chairman: Well, if we have taken all the information we can on the question of depletion, the next subject, I notice, is creditable tax. Now, the fact that you mentioned creditable tax, does that mean I have to assume that you support the White Paper theory of integration.

Mr. Kingsmill: I do not know if we have any comment, Mr. Chairman, as to whether we support the White Paper theory on integration. This has been a matter which has been commented on by a great many people. The point we are making in respect of the creditable tax is that if there are to be tax incentives to the resource companies then that will necessarily reduce the amount, and on integration it will reduce the amount of creditable tax which will be open for use by the Canadian shareholders.

Oddly enough, it gives rise to no penalty as far as the non-resident or non-Canadian shareholder. It does not constitute a problem for him at all.

The Chairman: No. The way it has been put here by other companies has been that the incentive, which is supposed to be provided by earned depletion, is taken away when the tax of the parent company is reduced. Therefore the creditable tax for the shareholder on the dividend is reduced.

Mr. Kingsmill: Yes.

The Chairman: And that in fact while they give the incentives with one hand to the company they then take it away via the shareholders in any dividend he might get because they do not propose to continue that incentive of depletion for the shareholder receiving dividends.

Mr. Kingsmill: Yes.

The Chairman: I have not heard anybody yet here who has come forward and expressed an interest in the shareholder that he should retain this depletion allowance on dividends. Are you going to be the exception and say, "Yes, that is right"?

Mr. Kingsmill: When you say retain depletion allowances, you are speaking here of the present depletion allowance in respect of dividends?

The Chairman: Yes, or any depletion allowance.

Mr. Kingsmill: Or any depletion allowance. Well, I think our recommendation in respect to that proposal provided would be a deemed creditable tax based on the depletion, in effect would achieve the same thing.

The Chairman: It would be an alternative way.

Mr. Kingsmill: Yes. The shareholder would then receive the benefit arising by virtue of the depletion allowance.

The Chairman: Any other questions?

Senator Connolly: Just one, Mr. Chairman. If the shareholder gets a depletion allowance, which is a dividend, surely that is an incentive to the Canadian investor to purchase this type of security if you became an integrated company and went public.

Mr. Kingsmill: Yes.

Senator Benidickson: He gets it now.

The Chairman: And it is an incentive.

Senator Connolly: It is an incentive.

The Chairman: Yes.

Senator Connolly: It is an incentive to invest in Canadian companies by Canadians.

Mr. Kingsmill: Yes.

The Chairman: There are two parties, Senator Connolly, to this business of risk capital, which is put up by way of money

advanced. These people are interested in getting paid back but you need some equity capital in a certain ratio or relationship and therefore the company getting the incentive is not enough. The person who is putting up the money as equity capital should have a direct incentive. Would you support that view?

Mr. Kingsmill: Yes, I would. I think that this truly becomes a matter of complete integration of the shareholder with his company to the extent it would be consistent with the overall White Paper proposal of integrating the shareholder with his company.

The Chairman: Certainly the White Paper proposal in this regard does not fully integrate the shareholder with the company.

Mr. Kingsmill: I would agree, sir.

The Chairman: Any other questions on this point? Were there some other points that you wished to develop, Mr. Heddon?

Senator Phillips (Rigaud): I do not think we need much discussion, Mr. Chairman, on the next point of quinquennial evaluation.

The Chairman: No. All you have to add is to say you are opposed to it.

Mr. Heddon: I can say that very quickly, sir. There are two of the other minor points in the brief but I do not think it is necessary to take the time of this Committee this evening. They are available for your perusal. They are tangential rather than affecting us as far as integration is concerned. I think they are quite self-explanatory.

Senator Connolly: They are the ones on page 18, "Deemed realization on Emigration" and "Convention, entertainment and related expenses."

Mr. Heddon: Yes. Those are the ones, Senator Connolly.

Senator Connolly: These are not very popular headings with the witnesses we have had before us.

The Chairman: No. We have had quite a few representations and I think the view expressed so far might be that there is ample provision in the present law to deal with entertainment expenses and this sort of specific is not necessary.

Senator Connolly: Expense-account living.

Mr. Heddon: Well, I may say that the Department of National Revenue has never

rejected any of our claims over all of the years as far as expenses are concerned. We think it is just very good business in Sun to maintain our own control of expenses. I might say I do not have a private account.

Senator Phillips (Rigaud): You are either being very conservative or you have good lawyers.

Mr. Heddon: I must say, sir, in Sun we are very conservative.

The Chairman: Now, if we have finished with this one I believe the same panel is going to present the case for Great Canadian Oil Sands Limited.

Are you going to make a statement in this regard?

Mr. Heddon: My statement, Senator Hayden, will be very, very brief; only to tell you that Mr. Rea, who is Chairman of the Board, will make the presentation on behalf of GCOS and Mr. Kingsmill will speak with regard to tax matters. If there are any tangential subjects, I will try to take them on.

The Chairman: We have already heard some of the stories of the tar sands, Mr. Rea, and we will be awfully interested in what you have to tell us.

Mr. W. Harold Rea, Chairman of the Board, Great Canadian Oil Sands Limited: Mr. Chairman, Great Canadian Oil Sands Limited, to which we will refer as GCOS, appreciates the opportunity to place before you the effect of the White Paper Proposals on Tax Reform as it applies to this company.

While you have listened to and read many submissions covering the entire field of taxation, GCOS has confined its brief to those tax incentives necessary to encourage the development of natural resources where high risks prevail in exploration and development.

The GCOS operation embodies many of the problems of both the mining and oil industries. In terms of materials handling, GCOS is one of the largest—if not the largest—mining operations in Canada and produces an extremely high quality light synthetic crude oil.

The existence in Alberta of what is considered the largest single reservoir of crude oil in the world, has tantalized the ingenuity of the geologist and engineer for over a century. How can this vast energy source be harnessed to compete in the market place with petroleum produced by conventional methods?

As you have already heard, it has attracted millions of dollars of research funds from many sources and has been studied by the most knowledgeable scientists of our time.

Let us turn back for a moment, to the early sixties, when GCOS operated a pilot plant on the present plant site, to test out its extraction process. At that time there had been a dearth of new oil discoveries on the North American continent and the United States oil reserves were declining, while the projected consumption curves on the other hand, pointed steadily upward. It seemed inevitable that the Tar Sands would have to be developed.

The situation could, to some degree, be likened to that which prevailed in the summer of 1942, during World War II, when Submarine warfare was seriously threatening Canada's source of petroleum from offshore. It will be recalled that the late C. D. Howe, then Minister of Munitions and Supply, directed that an intensive programme be undertaken to find a means of recovering the bitumen from the Tar Sands and committed public funds for the purpose.

In April of 1964, after confirming with the Department of Finance, the tax incentives which would be available to the company, namely, the rapid write-off of exploration and development costs, the three-year tax-free mining exemption and the depletion allowance, the company decided to proceed with a 45,000 barrel per day plant at a cost of \$200 million. This was at a time when our most conservative projections provided for a possible interest rate on borrowed capital, as high as 6%, for a high-risk project.

The plant, together with preproduction and extraordinary unanticipated start-up costs, has escalated the cost of our investment by over 50% to an amount in excess of \$300 million. While we have considered ourselves to have been in commercial production as of October 1st, 1968, since that date the company has suffered operating losses of approximately \$40 million at the end of March 1970. These figures illustrate the uncertainty and risk involved in a project such as ours.

The GCOS project has contributed greatly to the development of a remote area of Canada. The Town of Fort McMurray has grown in population from 1000 to 6000 and our GCOS annual payroll amounts to approximately \$5,800,000, most of which is paid to employees living in Fort McMurray. Other

benefits to the area include the salaries and wages of companies supplying maintenance and services.

Let us examine the situation GCOS faces today with respect to the tax proposals of the White Paper. GCOS cannot qualify for depletion allowance because in the White Paper proposal it is calculated as the lesser of 33 $\frac{1}{3}$ % of the company's production profits or one-third of its eligible expenditures, expended after November 7th, 1969. Inasmuch as our exploration and development was completed before November 7th, 1969, we will have no eligible expenditures.

Senator Connolly: You have found your ore body?

Mr. Rea: We have reached the ore.

Senator Connolly: You have found your ore body?

Mr. Rea: Yes, that is complete.

Senator Phillips (Rigaud): It is something like what we have heard about the open pit iron ore mines. They have iron ore running out of their ears.

The Chairman: For 100 years.

Mr. Rea: That is right.

Now that we have committed over \$300 million to the project, GCOS will not be entitled to any depletion allowance. This is most inequitable.

We believe that the depletion allowance that was available at the time we made the commitment to proceed should continue to apply to projects in the Athabasca Tar Sands. However, in our submission, we propose an alternative which, while less satisfactory from our standpoint, would provide tax treatment on a par with any subsequent Tar Sands developer.

The obvious question is: would we have proceeded with our investment had the tax laws, at that time, been as currently proposed under the White Paper? Any answer is, of course, conjectural. However, our investment was for a long term, with a narrow rate of return. The White Paper Tax proposals are less favourable. Any reduction in the return might well have resulted in a decision not to proceed in light of the high-risk pioneering nature of the undertaking.

The project has encountered many unforeseen problems which are gradually

being resolved and we intend to leave no stone unturned to make it a viable enterprise.

Now, the two main recommendations that we have have to deal with the depletion allowance and what we think should be done in the case of our company. That will be found on page 1, the first column, the last two paragraphs.

Senator Connolly: Mr. Rea, you have been in production for two years now. Can you tell the Committee why you are not in a profit position.

Mr. Rea: Well, we have been plagued with start-up problems. We lost about a year practically because our boilers could not be brought up to specifications so we ran at far less than capacity for well over a year until we resolved that boiler problem.

Senator Connolly: Bugs in your production system?

Mr. Rea: Yes. Now, in the design end of a plant such as this, it is awfully difficult for the designers and engineers to know just what type of steel to put in certain places. The product was corrosive, there is a lot of sulphur in it and one does not know just where that is going to hit.

They may provide for special steel for certain areas but in the operation of the plant something else goes at different places, so we have had untold—I do not know how many, shutdowns we had last year—something like 50.

These are the things that have plagued us. As we get one fixed up, we get that straightened up and by degrees we are getting them ironed out.

Senator Benidickson: You said one of the incentives, when you decided to go ahead with this rather unique enterprise, was the tax holiday for three years.

Mr. Rea: Yes.

The Chairman: And depletion?

Senator Benidickson: I was dealing only with the tax holiday. That was part of your decision but in fact it does not mean very much to you?

Mr. Rea: That is right.

Senator Beaubien: Mr. Rea, you have had a \$40 million loss in two years?

Mr. Rea: Yes. Since October the 1st, 1968 until March 31st of this year we have had a \$40 million loss, but then we have very...

Senator Beaubien: There is a very good reason why you paid no taxes?

Senator Aird: What is your forecast for the present fiscal year, Mr. Rea?

Mr. Rea: Well now, Senator Aird, we have a shareholders' meeting coming up next Monday and it is pretty hard to answer a question like that right here. I think at this point all I would say is that our losses this year to date are less than they were last year.

The Chairman: The tax holiday idea is one that is gone.

Mr. Rea: That has gone.

The Chairman: So your interest in the tax holiday at the moment is academic?

Mr. Rea: That is right.

Senator Beaubien: Depletion too?

The Chairman: But the depletion is the carrot or plum, or whatever you want to call it, if you are entitled to it on the present basis because some day when you start making money you will be able to use it.

Mr. Rea: That is right.

The Chairman: As unearned depletion?

Mr. Rea: That is right.

The Chairman: Otherwise you cannot use it at all, so you will be compelled to live without incentives although the White Paper says that the need for incentives is well recognized by the government.

Mr. Rea: On a new project under the White Paper, you can write off the whole costs but we cannot.

The Chairman: Yes.

Senator Connolly: Not only do you have to live without incentives, as the Chairman points out, but I take it if you lose the 33½ per cent depletion, the price of your product increases so you will not be compensative.

Would you be non-competitive if you lost it?

Mr. Rea: Well,...

Senator Connolly: Perhaps that is not a fair question. Perhaps I should put it this way.

Would you say that the cost of producing a barrel of oil in that plant in that area from the tar sands is more expensive than the cost of producing a barrel of oil from the conventional well?

Mr. Rea: Up to date, yes.

Senator Connolly: Will that continue?

Mr. Rea: Well, we hope it will not. Our objective is to get the cost reduced so we are competitive.

Senator Connolly: You must get competitive if you are to continue in business.

Mr. Rea: Yes, absolutely.

Senator Connolly: Well, let us go on then from where the Chairman started you. If you lose the depletion completely, what do you foresee as your competitive position?

Mr. Kingsmill: If I may interject, Mr. Chairman, I think if Great Canadian lost the depletion incentive completely then, of course, the result is that once it gets into a profit position its taxes would be higher and this impedes financing and impedes the return to shareholders and the return of the investment in development that Great Canadian has. You have an example...

The Chairman: Would not the real question be without depletion could you really get into a profitable position?

Mr. Kingsmill: Well, depletion, of course, is computed with reference to the profits so you have to have a profit before you can get depletion.

The Chairman: Plus the existence of depletion would entitle you to attract money?

Mr. Kingsmill: Yes. The problem, you see, that GCOS would have would be in returning money to investors. There is \$300 million which has been invested. How do you get it back?

The Chairman: That is right.

Mr. Kingsmill: And the project was founded on the economics of the tax incentive which, under the White Paper, would be entirely wiped out.

The Chairman: Well, the simple answer would appear to be that everybody agrees—even the White Paper agrees—that you are entitled to incentive and the effect of the White Paper proposals in your case is that you would have none?

Mr. Kingsmill: That is correct.

Senator Connolly: To go back to the question which you brought up in the very early part of our proceedings here, depletion is an intent or a method to repay to the owners a value for something of the wasting character of the assets that you are producing.

Now, as you go along in the tar sands—the tar sands are perhaps different because the quantities are so tremendous—does that apply to the tar sands too?

Mr. Rea: Yes. In our case, Senator Connolly, we have 3,800 acres in our region and we figure we could mine that out in 20 or 25 years. When we mine that out then our assets, or oil, is finished.

Senator Connolly: So you have to put the plant in somewhere else?

Mr. Rea: I think it would be hard to move that plant.

The Chairman: Are there any other questions? Senator Molson?

Senator Molson: I would like to ask Mr. Rea what the original forecast in these early years of GCOS was? At what stage did you contemplate, without the early problems, that you would get into the black? How long was contemplated in development?

Mr. Rea: Well, Senator Molson, I would just like to repeat that when we looked at it we realized it was a long term payoff. We figured we could be in the black in the early years.

At that time there was a shortage. The oil findings were very few and while it looked marginal at that time the question of supply and demand comes into it. We see the tremendous growth in consumption on the North American continent and right now a questionable volume of supply.

Well, what you might conclude from that was in turn there might be an increase in the price of crude. That has not happened yet so I will repeat, it was a long term payout.

We have felt that it will work out in time and maybe we will find ways of mining the sand and so on at a cheaper way than was projected with experience.

There is no experience in the world to look to at the present time so this was a pioneering adventure of the first order.

Senator Molson: Have you been able to appreciably change the process as a result of the two and a half years experience? I do not

want to ask you a question that would cause you any embarrassment. In general terms has there been any substantial changes in the process that have developed as a result of the knowledge you have acquired?

Mr. Rea: Well, yes. We have learned how to move large volumes and in the plant, of course, we have learned in the wintertime you cannot move the same quantity into the plant as you can in the summer because of the low temperatures and the tar sand just sticks to the belts and creates many, many problems.

We have found ways of overcoming this to some extent. We have found means of supplementing the supply in the plant in the winter months. We have learned a lot. I think each day that goes by we find ways of doing things more economically in refining our processes and so on. This is our hope for the future that we will gradually lick this whole problem.

The Chairman: Any other questions?

Senator Phillips (Rigaud): Yes. I have a question for Mr. Rea about his figures. Would it be feasible for the industry at large to work out an initial bookkeeping system whereby the present incentive was applied to present assets and provide incentives in respect to other acquisitions? I am speaking of the oil industry at large as well as the particular circumstances relating to your company.

Mr. Rea: Well, is this tied in with your question about should we eliminate depletion in 21 years.

Senator Phillips (Rigaud): No, it is not.

Mr. Rea: To what are you referring?

Senator Phillips (Rigaud): Just simply to say the present case is made for a natural resource company to have long-term financial resources which are related to tax incentives which are allowed.

Mr. Rea: Yes.

Senator Phillips (Rigaud): And the importation of those resources that you acquire related to incentives that the government said are available and should be continued.

The Chairman: That is a complicated problem, property not now found and enjoying any such incentives.

Mr. Rea: Yes.

Senator Phillips (Rigaud): As against that in the light of the feeling that benefits are too great, whether there is something to be said in favour of a lower set of incentives in respect of further exploration and development.

Mr. Rea: Well, that is a difficult question to answer.

Senator Phillips (Rigaud): Could we have a bookkeeping system that could give effect to that?

Mr. Rea: Well, I would have to think about that one.

The Chairman: You could answer the first part of it, and you could say you would approve of any law which continues in operation the existing incentives in relation to properties now operating.

Mr. Rea: Oh, yes.

Senator Phillips (Rigaud): It is just a case of how should anybody else be treated that came along?

The Chairman: That is a separate question.

Mr. Rea: Well, oil is such an important commodity to us sometimes I do not think we appreciate how quickly the whole situation can change on us. I can visualize in the Middle East where there are great tensions there, where the control of the whole oil picture might shift from east to west. Supposing the reserves in the Middle East fell under the control of Russia. This would change the whole atmosphere in this country. I think the urgency to develop the tar sands would be phenomenal because we must develop great resources of oil on the whole American continent.

The Chairman: Are there any other questions?

Senator Cook: Would you lose the benefit of carrying forward this \$63 million deficit? As the law stands now could you carry that forward against future profits?

Mr. Rea: Yes.

Senator Cook: It is not a question of carrying it forward a couple of years and then losing it?

Mr. Rea: No, we carry that forward.

Senator Benidickson: I think that is a business loss and that is something other than the available depletion to which we are addressing ourselves.

Senator Cook: Do you lose it say in a couple of years or can you carry it forward?

Mr. Rea: We will carry it forward, sure.

Senator Cook: For tax purposes?

Mr. Rea: Why, sure, we can.

Mr. Kingsmill: Yes, but it is subject to the length of the carry forward of business losses.

Senator Cook: Which is how long?

Mr. Kingsmill: I think it is five years.

The Chairman: One year back, five ahead. Are there any other questions. Mr. Rea, have you any more you would like to add? Mr. Kingsmill?

Mr. Rea: No, thank you, Mr. Chairman.

The Chairman: Thank you very much.

The meeting adjourned.

APPENDIX "A"

Submission by

Sun Oil Company Limited

regarding the
Government of Canada's
Proposals for Tax Reform

Index

Summary

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—History and Objectives

Sun's Comments and Proposals

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Development Costs
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Section IV—Quinquennial
Revaluation
Section V —Other
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Summary

It is Sun's objective to integrate the exploration and production operations of the Canadian branch of the U.S. parent company with the refining and marketing operations of the Canadian company and to issue shares of the integrated company to the Canadian public. It is therefore the purpose of this brief to deal primarily with those tax matters which would impede Sun's goal of integration and on which Sun believes it can make a valuable contribution toward achieving the goal of reasonable tax reform. Accordingly, Sun makes the following proposals:

(1) Exploration and Development Costs

Sun proposes a tax-free "roll-over" of oil and gas rights and related exploration and development expenditures between associated companies.

(2) Depletion

Sun agrees with previous submissions that Canadian

depletion allowance should be based on gross production income and be at a rate similar to that in the United States.

(3) Creditable Tax

Sun proposes that there be a deemed creditable tax so that tax incentives such as depletion are not largely eliminated when the corporation's earnings are distributed to shareholders.

(4) Quinquennial Revaluation

Sun proposes that quinquennial revaluation not be enacted as it would discourage Sun from having the Canadian company issue shares to the Canadian public.

In addition to the above proposals, Sun has made comments on certain other aspects of the White Paper which, for the purposes of brevity and because of the fact that these comments do not relate directly to Sun's objective of integration, are not repeated here.

Introduction

The Sun organization in Canada

Sun Oil Company Limited appreciates the opportunity to participate in the important public discussion on the proposals for tax reform contained in the White Paper of November, 1969. The Minister of Finance and his Department are to be commended for their efforts in bringing the proposals before the Canadian public and inviting their consideration of them.

We agree with certain of the proposals and with certain of the submissions which already have been made on them. In the interests of brevity, we do not intend to reiterate points of view which have been most adequately expressed by others.

Prior to commenting on the proposals Sun believes it would be beneficial to briefly outline

the history and objectives of Sun in Canada.

History

Sun Oil operations in Canada began in 1919 with the opening of a small marketing branch in Montreal. Currently major operations are carried on by the Calgary-based Canadian Region of the North American Exploration and Production Group of Sun Oil Company and by Sun Oil Company Limited, incorporated in Canada in 1923, a wholly-owned subsidiary of Sun Oil Company.

There is a third major operation, Great Canadian Oil Sands Limited (GCOS), which is a subsidiary of Sun. There are, however, some very substantial differences between the GCOS operation and the operations of the other Sun enterprises in Canada. GCOS is a pioneering

venture in mining and processing the bituminous sands of north-eastern Alberta. The nature of this operation is such that, from an extractive standpoint, it is an entirely new industry founded on a new technology. Approximately \$300 million has been invested to date to bring the GCOS facilities to their present operational state.

GCOS differs from Sun's other operations for yet a second reason. It is a public company with shares listed on the Toronto and Calgary stock exchanges. Approximately 7,400 Canadians hold GCOS shares and approximately 82,000 Canadians hold GCOS partially convertible debentures. Great Canadian Oil Sands has prepared a separate brief on the tax reform proposals.

Sun has been engaged in major conventional exploration and production activities in Canada since the late Forties, resulting in the development of substantial oil and natural gas deposits in all the western provinces. While the search continues in these older producing areas, the Company has not neglected the many interesting but unexplored frontiers in Canada. Exploration efforts are underway in the Northwest Territories, the Arctic islands, Hudson Bay and Quebec. The approximate gross investment in exploration and development activity over the past 20-odd years is in excess of \$150 million.

Manufacturing and marketing activities are carried on by Sun Oil Company Limited in Ontario and Quebec. The Company operates a 35,000 barrel-per-day refinery at Sarnia and holds the majority interest in Sun-Canadian Pipe Line Company Limited which operates a

products line from Sarnia to Toronto. Bulk plants and distribution facilities are located in London, Hamilton, Toronto, Ottawa, Montreal and Quebec City.

In addition to gasoline and heating oils, Sun Oil Company Limited is a major supplier of industrial lubricating oils and other petroleum products to industry.

Total investment in manufacturing and marketing activities now totals about \$120 million.

Objectives

Among the major objectives of Sun in Canada is the integration of its conventional exploration and production operations and its refining and marketing operations into one corporate enterprise. As an important part of that objective, Sun intends to issue shares to Canadians.

To some extent we have already moved toward integration. Employees of Sun companies in Canada enjoy a standard benefits program. Also, there is a common administrative responsibility for taxes, human resources, payroll, public relations and supply and transportation for all Sun companies in Canada.

We note with interest that our objectives of integration and Canadian equity participation appear to be in accord with government policy and pronouncements on this subject. We must observe quite candidly however that further progress toward these objectives will depend on a number of factors not the least of which is present and proposed tax legislation. It is, therefore, the purpose of this brief to deal primarily with those tax matters which would impede our goal of integration and to propose viable alternatives.

Section I

Exploration and development costs

Section I—Exploration and development costs

Present law

(Sections 17 and 83A)

A corporation which has as its principal business the production of oil and/or gas may deduct Canadian exploration and development expenses as incurred. The definition of exploration and development expenses includes oil and gas rights acquisition cost.

Proceeds received upon the disposition of oil or gas rights are included in computing the income of the vendor for tax purposes. Dispositions between non-arm's length taxpayers must be accounted for at the fair market value.

Where a corporation buys all or substantially all of the property of a seller corporation used by the seller corporation in carrying on its business in Canada, the buyer corporation is entitled to deduct, in computing its income for tax purposes, the exploration and development expenses not previously deductible by the seller corporation to the extent that income is derived by the buyer corporation from the property acquired from the seller corporation.

White Paper proposals

(Paragraphs 5.25 to 5.28 inclusive)

The White Paper proposes no change for corporations who meet the principal business test.

Sun Oil Company Limited's proposal

A tax-free "rollover" of the oil and gas rights and related exploration and development expenses should be allowed between associated corporations. Also the restriction relating to the deductibility of such expenses after the transfer should be removed in the case of a transfer between associated corporations. However, to prevent this proposal from allowing the sale and purchase of companies for tax purposes only, provision should be made that exploration and development costs of a corporation at the time control was acquired by another corporation could not be carried forward unless the fair market value of the oil and gas rights of the acquired corporation were equal to or exceeded the exploration and development costs to be carried forward.

Why

Sun Canada has as a major objective the integration of its refining and marketing facilities with the conventional Canadian oil and gas production operations of the other Sun organizations in Canada. A major barrier to this objective is the tax cost related to the transfer of the oil and gas rights which are estimated to have a fair market value in excess of \$95 million. After deducting exploration and development costs not previously deducted—approximately \$65 million—the balance of \$30 million would be subject to tax of approximately \$15 million if integration were to go ahead. While this cost would probably be recovered in the future depending on the integrated company's profitability and the extent of its exploration and development activities, the prospect of an immediate \$15 million outlay does not encourage integration.

In short, we feel that Sun should not be penalized if it were to reorganize its investment in a manner desirable for business reasons and which would enable Canadians to enjoy equity participation in an integrated Sun Oil Company Limited.

Section II

Depletion

Section II—Depletion

Present law

(Section 11 and Regulation 1201)

An oil and gas corporation is entitled to a depletion allowance of 33⅓% of its profits derived from the production of crude oil and gas and as determined in accordance with the applicable regulations.

White Paper proposals

(Paragraph 5.40)

Under the White Paper proposals percentage depletion would be withdrawn and replaced by earned depletion. Earned depletion would be equal to ⅓ of exploration and development costs (excluding acquisition costs of oil and gas rights) and would be deductible in calculating the corporation's income up to the current maximum of 33⅓% of production profits. Any excess of earned depletion could be carried forward indefinitely.

Sun Oil Company Limited's proposal

Sun believes that the depletion incentives to the oil and gas industry as finally enacted should be at least as advantageous as those granted to the industry in the United States. Several alternatives to the White Paper proposal on depletion have already been suggested by other companies. We favour the alternative of gross depletion.

Why

Sun opts for the gross depletion alternative because:

(1) Canada is a growing country with an economy which must compete on world markets. Increasingly it is dependent upon low cost sources of energy of which the most important are petroleum and natural gas. Significantly new major sources of these raw materials must now be sought in such high risk, high cost areas as the Arctic and off-shore. The depletion incentive should recognize these factors. The large amounts expended by the oil and gas industry in the search for and the development of sources of petroleum and natural gas have made a significant contribution to the Canadian gross national product. In addition the export of petroleum and natural gas to the United States has assisted greatly the Canadian balance of payments position.

(2) Sun relates the depletion incentive to its objective of integration. Under both the current law and the proposal it is more beneficial for a U.S. corporation to carry out exploration and production activity in Canada through a branch operation than through a Canadian subsidiary company, at least until the branch earns significant profit for tax purposes. This occurs because, even though the branch operation may operate at a loss, gross depletion on Canadian production may be deducted in calculating income subject to tax in the United States. This situation gives a competitive advantage to the U.S. corporation at the expense of Canadian corporations. If Canadian depletion is less than that available in the U.S. it would represent an additional tax cost to Sun should Sun integrate its Canadian exploration and production operations with its refining and marketing operations.

Section III

Creditable tax

Section III—Creditable Tax

Present law

(Sections 6 and 38)

Gross dividends from taxable Canadian corporations are included in an individual's ordinary income. If the dividend is from a resource company the individual may deduct up to 20% of the gross dividend as depletion. The individual may then deduct from his tax liability 20% of the net dividend received.

White Paper proposals

(Paragraph 4.36)

The White Paper proposes that the current dividend tax credit and depletion allowance, if applicable, would be discontinued and replaced by credible tax. In the case of an individual, he would include in his income the dividend received (cash or stock) plus the related credible tax. The credible tax would be equal to 50% of the taxes paid by the widely-held corporation on the earnings from which the dividend was paid. The amount of credible tax would then be deducted from the individual's total tax liability and, if in excess of the liability, the excess would be refunded to the shareholder.

Sun Oil Company Limited's proposal

Grant to the shareholders of resource companies a deemed creditable tax in addition to the creditable tax which would be allowed under the White Paper proposals. This deemed creditable tax would be equal to 50% of the additional tax which would have been paid if the corporation had not deducted depletion in calculating its income subject to tax. Similar deemed creditable tax should also be granted to shareholders which would recognize the various timing differences which exist between taxable income and book income. Such differences can be caused by the deduction of capital cost allowances for tax purposes versus book depreciation and the rate of write-off of exploration and development costs for tax versus book purposes. To prevent the situation arising whereby the government could possibly be refunding tax which it would not receive, the deemed creditable tax relating to depletion would not be refundable to the shareholders.

Why

The White Paper proposals include various incentives to industry such as accelerated capital cost allowances, deductibility of all exploration and development costs and depletion. These incentives to corporations would be largely eliminated when the corporation's earnings are distributed to its shareholders unless provision is made for a deemed creditable tax. (See Appendix for comparison of net return to a shareholder under the current law, White Paper proposal and Sun's proposal.) Under the White Paper proposals, if implemented, the time at which Sun would find it economically feasible to issue shares of the integrated Canadian company would certainly be delayed.

Section IV

Quinquennial revaluation

Section IV—Quinquennial Revaluation

Present law

No parallel provision exists in current law.

White Paper proposals

(Paragraph 3.33)

Shares of widely-held Canadian corporations are to be revalued every fifth year and one-half of any increase in value would be subject to tax at ordinary rates for individuals and closely-held corporations resident in Canada. Non-resident shareholders holding 25% or more of the outstanding shares would also be subject to tax.

Sun Oil Company Limited's proposal

Sun recommends that the proposal to tax unrealized gains in the value of shares of widely-held Canadian corporations not be enacted.

Why

The White Paper proposal to tax unrealized increases in the value of shares of widely-held Canadian companies in effect imposes a tax penalty on foreign corporations for co-operating with the government's previously announced intention of encouraging wholly-owned subsidiaries of foreign corporations to issue shares to the Canadian public. It is unlikely that the foreign corporation would receive a foreign tax credit in its own country to offset the tax on the unrealized gain. The proposal, as set forth in the White Paper, is certain to delay the time at which Sun Oil Company Limited issues shares to the Canadian public.

Section V
Other

There are two other proposals in the White Paper on tax reform on which Sun wishes to comment. They are the proposal for a deemed realization of assets at the time of emigration and convention, entertainment and related expenses.

Deemed realization on emigration

An international organization such as Sun finds significant benefits for both the Company and its employees in arranging temporary employment transfers from the employee's normal country of residence.

Such transfers expose the employee to various areas of the Company's operations and provide him with an excellent opportunity to learn about those activities and new up-to-date management techniques which prepare him to work effectively in more senior management positions.

Also, Sun finds that complicated operating and technological problems arise in its operations and that an employee resident in another country is familiar with such problems and can solve these problems over a relatively short period of time.

The White Paper proposals are certain to discourage such temporary transfers to the detriment of the employee, the com-

panies and in the long run, Canada.

Accordingly, Sun proposes that if such a provision is enacted, employees on temporary assignments of up to five years in Canada or out of Canada be exempted from this provision for a deemed realization of assets.

Convention, entertainment and related expenses

Sun believes that convention, entertainment and related expenses should continue to be allowed to the extent they are reasonable.

Significant educational benefits are to be obtained by sending employees to conventions and other gatherings. Sun has always considered that its entertainment expenses have been reasonable. This has been borne out by the fact that the Department of National Revenue has never questioned the propriety of such expenses.

Section VI

Appendix

Creditable tax

Comparison of net return to a shareholder

	Current		White Paper Proposal		Sun Proposal
	Resource Company	Industrial Company	Resource Company	Industrial Company	Resource Company
Corporate income before tax	\$3,000	\$3,000	\$3,000	\$3,000	\$3,000
Tax after depletion	1,000	1,500	1,000	1,500	1,000
Dividend	2,000	1,500	2,000	1,500	2,000
Shareholder depletion	400	N/A	N/A	N/A	N/A
Gross up equal to ½ of tax paid	N/A	N/A	500	750	750*
Amount to be included in shareholder's income	1,600	1,500	2,500	2,250	2,750
Shareholder tax @ 50%	800	750	1,250	1,125	1,325
Tax credit—20% of net dividend	320	300	N/A	N/A	N/A
—Creditable tax	N/A	N/A	500	750	750*
Net shareholder tax	\$ 480	\$ 450	\$ 750	\$ 375	\$ 575
Net return to shareholder	\$1,520	\$1,050	\$1,250	\$1,125	\$1,425

*includes deemed creditable tax of \$250.

APPENDIX "B"

Submission by

Great Canadian Oil Sands
Limited

regarding the
Government of Canada's
Proposals for Tax Reform

Great Canadian Oil Sands Limited

Summary

Great Canadian Oil Sands Limited ("GCOS") has constructed and is now operating the first plant which has ever produced on a commercial basis synthetic crude oil derived from the Athabasca Tar Sands.

The existing tax incentives, being the three-year new mine exemption, the deductibility of exploration and development expenses and the 33½ per cent depletion allowance, had a most important effect on our decision to proceed with the project.

If the White Paper proposal on depletion is implemented, GCOS will no longer have any entitlement to or prospect of ever obtaining a depletion allowance. This would be most inequitable. The project was founded upon the economics of the depletion allowance.

Recommendation on Depletion

We recommend that the present depletion allowance continue to be fully applicable to synthetic crude oil operations in the Athabasca Tar Sands.

As a far less satisfactory alternative, we recommend that our Company at least be entitled to carry forward into 1976 (being beyond the five-year transitional period under the proposed new system) as "earned depletion" the difference between (a) one-third of the total of our expenses incurred from the inception of our operations which would have been "eligible expenditures" had the proposals been in effect and

(b) the total of all unearned depletion claimed up to the end of 1975 (being the end of the five-year transitional period under the proposed new system).

Introduction

Great Canadian Oil Sands Limited ("GCOS") appreciates this opportunity to participate in the important public discussion on the proposals for tax reform contained in the White Paper of November, 1969. The Minister of Finance and his Department are to be commended for their efforts in bringing the proposals before the Canadian public and inviting their consideration of them.

We agree with certain of the proposals and with certain of the submissions which already have been made on them. In the interests of brevity, we do not intend to reiterate points of view which have been most adequately expressed by others. We feel that our contribution to the discussion might best be confined to noting the importance of tax incentives to a resource project such as ours and to pointing out our particular concern over the White Paper proposal on depletion.

GCOS

Our Company has constructed and is now operating the first plant which has ever produced on a commercial basis synthetic crude oil derived from bitumen recovered from bituminous sands mined from the Athabasca Tar Sands. The Athabasca Tar Sands is a deposit of quartz, sand and clay impregnated with heavy oil or

Great Canadian Oil Sands Limited

bitumen located in the Athabasca River region of northeastern Alberta.

The plant and mining operation are located on the west bank of the Athabasca River approximately 20 miles north of Fort McMurray and 220 miles north of Edmonton. (See map). We have invested \$256,000,000 in constructing the plant, including preproduction and development expenses of \$90,000,000. In addition, \$3,000,000 has been spent in constructing a road from the plant to Fort McMurray, \$2,000,000 as our contribution towards the cost of a bridge over the Athabasca River, \$13,000,000 in employee housing facilities in Fort McMurray and \$16,000,000 in constructing a product pipeline from the plant to Edmonton. As well, our parent, Sun Oil Company Limited, has invested over \$8,000,000 to provide a supply of natural gas to the plant.

Employment at the project now totals about 650 plus another 425 who work for contract maintenance and service companies. Plant operating costs in 1969, which comprised payroll, materials, supplies and contracted services, exceeded \$30,000,000. In 1969, we paid royalties to Alberta in excess of \$2,000,000 and municipal taxes of about \$300,000. As a result of our operation, Fort McMurray has become a modern town, with shopping centres, over four hundred single-dwelling homes, duplexes, apartments, motels, schools, a hospital and up-to-date

recreational facilities.

The plant was formally dedicated on September 30, 1967, but because of start-up difficulties due to equipment failures, operations did not commence on a commercial basis until October 1, 1968. From October 1, 1968, to December 31, 1969, we incurred a loss of \$34,000,000 which, when added to 1968 extraordinary preproduction and start-up costs of \$29,000,000, resulted in a deficit of \$63,000,000 at December 31, 1969. Our deficit has steadily increased since that date.

Our original permit from Alberta entitled us to build a plant with a synthetic crude capacity of 31,500 barrels per calendar day. Further economic studies indicated that, in view of rising costs, taxes and wages, we would require a plant with a daily capacity of 45,000 barrels of synthetic crude in order to have a successful operation. Accordingly, before we committed our project we made further submissions to the Alberta Oil and Gas Conservation Board and in April, 1964, GCOS obtained from Alberta an increase in its authorized production to a level of 45,000 barrels of synthetic crude per calendar day.

GCOS still appreciated, however, that in committing the project there remained great risks. As stated in the March, 1965, report of the directors to the shareholders of the Company, "It is recognized . . . that your Company has undertaken a major pioneering venture and that there are vari-

ables, such as interest rates on debt yet to be incurred, price of crude oil, wages, etc., which will affect the degree of the financial success of your Company."

Importance of Tax Incentives

We cannot over-emphasize the importance that the tax incentives had in the decision to proceed with the project. These incentives were the three-year new mine exemption, the deductibility of exploration and development expenses and the 33½ per cent depletion allowance. Indeed, the Department of Finance was most helpful and co-operative in assuring that each of these incentives would be available to GCOS.

Three-year New Mine Exemption

The proposed elimination of the three-year new mine exemption after December 31, 1973, is of no consequence to our present operation. By then our three-year exempt period will have long since expired. So far, of course, we have received no benefit from this exemption. Particularly in light of our losses to date, it is unlikely that we will ever receive any benefit from this exemption. Thus, the exemption encouraged our development but, as matters have turned out, it will not result in any actual reduction in tax collected by Canada. Tax incentives, as distinguished from subsidies, do not cost anything if the operation is not profitable.

Exploration and Development Expenses

The White Paper proposals do not

change the status of exploration and development expenses; they would continue to be deductible.

Percentage Depletion

Under the present tax law, GCOS is entitled to a depletion allowance of 33½ per cent of its profits derived from the production of synthetic crude and as determined in accordance with the applicable regulations.

Under the White Paper proposals, after a five-year transitional period, GCOS would be entitled to a depletion allowance equal to the lesser of one-third of its production profits or one-third of its "eligible expenditures". "Eligible expenditures" would consist of amounts expended after November 7, 1969, on exploration and development (other than property acquisition costs) of a resource in Canada and of amounts expended after November 7, 1969, on buildings, mining machinery and equipment acquired for the purpose of gaining or producing income from a new mine in Canada.

If the White Paper proposal on depletion is implemented, GCOS will no longer have any entitlement to or prospect of ever obtaining a depletion allowance. This would be most inequitable. The project was founded upon the economics of the depletion allowance.

GCOS has found its mineral deposit. Its entire project is committed to the exploitation of its mineral deposit. Moreover, GCOS

Great Canadian Oil Sands Limited

before November 7, 1969, acquired its buildings, mining machinery and equipment for its new mine.

The loss of the depletion allowance could have a very real adverse effect on the more than 7,400 shareholders and the more than 82,000 holders of partially convertible debentures who have invested in GCOS.

Furthermore, assuming for the moment that there will be other developers in the Athabasca Tar Sands, the elimination of depletion for GCOS would put GCOS at a serious disadvantage vis-à-vis the subsequent developer. The subsequent developer would incur its costs after November 7, 1969, and, thus, would at least have some "eligible expenditures" in respect of which it would be entitled to a depletion allowance under the White Paper proposal.

We recommend that the percentage depletion allowance under the present tax laws continue to be fully applicable to synthetic crude oil operations in the Athabasca Tar Sands. Otherwise, the development of this great resource will be jeopardized. It might well be noted that, notwithstanding strong submissions to the contrary, the United States retained the principle of percentage depletion in its recent overhaul of its tax legislation as set forth in the 1969 Tax Reform Act.

As a far less satisfactory alternative, but as a minimum to preserve at least some equity as between the pre-White Paper pioneer

developer in the Tar Sands and the post-White Paper developer in the Tar Sands, we recommend that our Company be entitled to carry forward into 1976 (being beyond the five-year transitional period under the new system) as "earned depletion" the difference between (a) one-third of the total of our expenses made from the inception of our operations which would have been "eligible expenditures" had the proposals been in effect and (b) the total of all un-earned depletion claimed up to the end of 1975 (being the end of the five-year transitional period under the new system).

Other Developers of the Athabasca Tar Sands

GCOS is desirous of others undertaking Tar Sands projects within the general area of our operation. We have facilities which we can share advantageously. Moreover, other developers will add economic strength to the general area of Fort McMurray, and thus to Alberta and to Canada. Consequently, we are disturbed by the statements of Syncrude Canada Ltd. and Imperial Oil Limited to the effect that the elimination of the three-year mining tax exemption and the drastic reduction of the depletion allowance proposed in the White Paper "would almost certainly kill" the Syncrude project.





Second Session—Twenty-eighth Parliament
1969-70

THE SENATE OF CANADA
PROCEEDINGS
OF THE
STANDING SENATE COMMITTEE
ON
BANKING, TRADE AND COMMERCE

The Honourable **SALTER A. HAYDEN**, *Chairman*

No. 34

WEDNESDAY, JUNE 17th, 1970

Twenty-Eighth Proceedings on the Government White Paper,
entitled:

"PROPOSALS FOR TAX REFORM"

WITNESSES:

(For list of witnesses see Minutes of Proceedings—Page 34 : 5)

APPENDICES:

- "A"—Brief from the Canadian Bar Association.
- "B"—Brief from The International Nickel Company of Canada, Limited.
- "C"—Brief from the Province of Quebec Chamber of Commerce.
- "D"—Brief from The Chemical Institute of Canada.
- "E"—Brief from TransCanada Pipe Lines Limited.

THE STANDING SENATE COMMITTEE ON
BANKING, TRADE AND COMMERCE

The Honourable Salter A. Hayden, *Chairman*

The Honourable Senators:

Aird	Croll	Isnor
Aseltine	Desruisseaux	Kinley
Beaubien	Everett	Lang
Benidickson	Gélinas	Macnaughton
Blois	Giguère	Molson
Burchill	Grosart	Phillips (<i>Rigaud</i>)
Carter	Haig	Walker
Choquette	Hayden	Welch
Connolly (<i>Ottawa West</i>)	Hays	White
Cook	Hollett	Willis—(30)

Ex officio members: Flynn and Martin

(Quorum 7)

ORDERS OF REFERENCE

Extract from the Minutes of the Proceedings of the Senate, November 19, 1969:

“With leave of the Senate,
The Honourable Senator Martin, P.C., moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on Banking, Trade and Commerce be authorized to examine and report upon the White Paper intituled: “Proposals for Tax Reform”, prepared by the Minister of Finance, and tabled in the Senate on Tuesday, 18th November, 1969.

After debate, and—

The question being put on the motion, it was—
Resolved in the affirmative.”

Extract from the Minutes of the Proceedings of the Senate, December 19, 1969:

“With leave of the Senate,
The Honourable Senator Phillips (*Rigaud*), moved, seconded by the Honourable Senator Robichaud, P.C.:

That the Standing Senate Committee on Banking, Trade and Commerce be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—

The question being put on the motion, it was—
Resolved in the affirmative.”

Extract from the Minutes of the Proceedings of the Senate, February 18, 1970:

“With leave of the Senate,
The Honourable Senator McDonald moved, seconded by the Honourable Senator Hayden:

That the Standing Senate Committee on Banking, Trade and Commerce have power to sit during adjournments of the Senate.

After debate, and—

The question being put on the motion, it was—
Resolved in the affirmative.”

ROBERT FORTIER,
Clerk of the Senate.

MINUTES OF PROCEEDINGS

WEDNESDAY, June 17th, 1970.
(54)

MORNING SITTING

Pursuant to adjournment and notice the Standing Senate Committee on Banking, Trade and Commerce met this day at 9:00 a.m. to further consider:

The Government White Paper entitled: "Proposals for Tax Reform".

Present: The Honourable Senators Hayden (*Chairman*), Aseltine, Beaubien, Benidickson, Blois, Burchill, Carter, Connolly (*Ottawa West*), Cook, Desruisseaux, Everett, Flynn, Gélinas, Haig, Hollett, Isnor, Macnaughton, Molson, Phillips (*Rigaud*) and Welch—(20).

In attendance: Roland B. Breton, Executive Secretary.

WITNESSES:

The Canadian Bar Association:

Mr. Ronald C. Merriam, Q.C., Secretary;
Mr. D. M. Clark, Q.C., Chairman;
Mr. W. A. Macdonald, Q.C., Vice-Chairman;
Mr. R. H. E. Walker, Q.C., Vice-Chairman;
Mr. W. M. Carlyle, Member;
Mr. H. P. Crawford, Member;
Mr. J. M. Fuke, Member.

International Nickel Company:

Mr. H. S. Wingate, Chairman;
Mr. J. C. Parlee, Senior Executive Vice-President;
Mr. H. C. F. Mockridge, Osler, Hoskin & Harcourt;
Mr. H. P. Crawford, Osler, Hoskin & Harcourt;
Mr. R. D. Brown, Price, Waterhouse & Co.;
Dr. E. J. Spence, York University;
Mr. I. McDougall, Deputy Comptroller;
Mr. R. N. Broderick, Assistant Comptroller;
Mr. D. B. Craig, Tax Manager, Canada.

At 12:35 p.m. the Committee adjourned.

AFTERNOON SITTING

2:15 p.m.
(55)

At 2:15 p.m. the Committee resumed.

Present: The Honourable Senators Hayden (*Chairman*), Beaubien, Blois, Burchill, Carter, Cook, Gélinas, Haig, Hollett, Isnor, Molson, Phillips (*Rigaud*) and Welch—(13).

Present, but not of the Committee: The Honourable Senator Laird—(1).

In attendance: Roland B. Breton, Executive Secretary.

WITNESSES:

The Province of Quebec Chamber of Commerce:

Mr. Rene C. Alary, Member of the Executive, Associate of Deschenes, Colas, De Grandpre and associates;

Mr. Victor St-Onge, Member of the Administrative Council, Tax Manager, Quebec-Cartier Mining Company Inc.;

Mr. Guy Charette, Counsel, Touche, Ross and Company;

Mr. Jean-Paul Letourneau, General Manager;

Mr. Gilles Champagne, Director of Research.

The Chemical Institute of Canada:

Mr. W. H. C. Simmonds, Director of Science Policy;

Dr. N. S. Grace, Past President;

Dr. L. W. Shemilt, President;

Professor P. Grenier, Professional and Provincial Affairs;

Dr. J. W. Tomecko, Chairman of the Board of Directors;

Dr. H. R. L. Streight, Vice-President and President Elect;

Mr. T. H. G. Michael, General Manager.

*The Honourable Senator Phillips (*Rigaud*) *Acting Chairman* in the Chair.

TransCanada Pipelines Limited:

Mr. J. W. Kerr, Chairman & Chief Executive Officer;

Mr. G. W. Woods, Group Vice-President and Director;

Mr. R. S. Wall, Vice-President and Treasurer;

Mr. R. Sim, Manager, Tax Department.

Ordered: That the documents submitted at the meeting today be printed as appendices to these proceedings, as follows:

A—Brief from the Canadian Bar Association.

B—Brief from The International Nickel Company of Canada Limited.

C—Brief from the Province of Quebec Chamber of Commerce.

D—Brief from The Chemical Institute of Canada.

E—Brief from TransCanada Pipelines Limited.

At 5:00 p.m. the Committee adjourned to the Call of the Chairman.

ATTEST:

Frank A. Jackson,
Clerk of the Committee.

**THE STANDING SENATE COMMITTEE ON BANKING,
TRADE AND COMMERCE
EVIDENCE**

Ottawa, Wednesday, June 17, 1970

The Standing Senate Committee on Banking, Trade and Commerce met this day at 9 a.m. to give further consideration to the White Paper entitled "Proposals for Tax Reform".

Hon. Salter A. Hayden (*Chairman*) in the Chair.

The Chairman: Honourable senators, I call the meeting to order. Our first submission this morning is from the Canadian Bar Association, but I believe, Senator Everett, there is something you wish to say as a preliminary matter.

Senator Everett: Mr. Chairman, we did not have time last week fully to consider the outstanding brief from the Canadian Institute of Chartered Accountants. There were certain sections which were not considered by the committee, and with the committee's permission I would like to put those sections on the record of today's proceedings, because I think they are important to the final report of the committee.

The first is section C-36, concerning safe haven rules for valuations. Then we have D-14, D-32, D-33, D-34, D-35, D-36 and D-37, which concern valuations under partnership and closely-held corporations, and indicate that there is a retroactivity to the valuation of these organizations under the Government proposal—something which I do not think any Government should ever get itself involved in.

Then there are sections D-38 and D-39 regarding pre-existing surplus of corporations; and sections E-2, E-3, E-4, E-5, E-6, E-7, E-8 and E-9, regarding the fact that it is the belief of the Canadian Institute of Chartered Accountants that goodwill should not be a depreciable asset.

The Chairman: Are those all the items?

Senator Everett: Yes, Mr. Chairman.

The Chairman: It may well be they have not reached the printing stage on the hearing of last week, and we can put them right into that instead of in the record of today's hearing.

Senator Everett: If my verbal remarks could be included in the record of today's hearing and the items incorporated in the record of the last proceedings, that would be satisfactory.

The Chairman: If that is the way you want it.

Senator Everett: Thank you very much, Mr. Chairman.

The Chairman: We have Mr. Merriam here, who is not unknown to us. Mr. Merriam, you are going to make the opening statement, and would you introduce your panel?

Mr. Ronald C. Merriam, Q.C., Secretary, The Canadian Bar Association: Mr. Chairman and honourable senators, first of all, may I express to you the appreciation of the Canadian Bar Association for this opportunity to be present this morning to present to you our comments with respect to the White Paper on Taxation and to discuss those comments with you.

At this time I should also like to express to you the regrets of our President, Mr. Pattillo, who unfortunately is unable to be present because he is in western Canada attending meetings of our provincial branches.

Mr. Chairman, to put the matter into perspective, I would like to outline briefly the procedure we have followed in preparing this brief. As honourable senators may be aware, the Canadian Bar Association represents somewhere between 12,500 and 13,000 lawyers from coast to coast in Canada. Even before the White Paper was published we appointed a special committee, which was again representative of the profession, from coast to coast in Canada, that committee being composed of men who are knowledgeable and experienced in tax law, and spend the greater

part of their work in that field or in associated fields. We did this deliberately, because it was our belief that if the Canadian Bar Association was to make a meaningful and beneficial submission, it must be one that was done in depth by men who knew what they were talking about because of their experience in this field.

That special committee met immediately the White Paper was made public. It divided itself into subcommittees, each of which assumed responsibility for the in-depth study of a particular section of the White Paper. The committee met in plenary session from time to time throughout the weeks following the making public of the White Paper.

In addition, we have in our association what is known as the taxation section, whose principal interest is in the field of tax law, and in each province we have a taxation subsection. The White Paper was referred to each of those subsections, with the request that it be studied, and the comments of each of those subsections forwarded to our special committee. We also publicized to the membership at large the fact that we had this special committee and invited comments from any member interested in making comments.

All of these studies were funnelled into the special committee, and the brief which is before you this morning represents the consensus of the views of that committee, after having studied the comments of the subsections and of individual members, and after having given serious consideration to drafts that had been prepared from time to time and circulated to all members of the committee. I therefore think it is fair to say that the brief we are presenting represents the considered thinking of a great many lawyers in Canada familiar with the field of tax law.

While, incidentally, the major credit for this brief must go to the members of that special committee, whose names are included in the letter of transmittal which I forwarded to the Chairman when sending in the brief, the brief has been approved by the executive of our association, and we are here this morning as the official representatives of the Canadian Bar Association to present to you and discuss with you the official submission of that association. I think it goes without saying from what you have just heard that this represents a tremendous number of man hours, all of which have been donated on a purely voluntary basis.

Mr. Chairman and honourable senators, if I may, I should like to introduce to you the

gentlemen who are with me this morning as representatives of our association. On my immediate right is Mr. D. M. Clark, Q.C., of Vancouver, who is Chairman of our Special Committee, and to whom a great deal of credit must go for an excellent job in having co-ordinated and organized the work of the committee, culminating in the preparation of this brief. It has not been an easy task. Next to him is Mr. H. P. Crawford, Q.C., of Toronto, who will be the major spokesman for our group this morning. Next to Mr. Crawford is Mr. W. A. Macdonald, Q.C., of Toronto; Mr. R. H. E. Walker, Q.C., of Montreal; Mr. W. M. Carlyle of Vancouver; and Mr. J. M. Fuke of Toronto.

Without saying anything further, Mr. Chairman, may I ask Mr. Clark to say a few words.

Mr. D. M. Clark, Chairman, Special Committee, The Canadian Bar Association: Mr. Chairman, honourable senators, I have very little to say, except that Mr. Crawford has been appointed our spokesman and will make an opening statement on the brief. He will not go through it section by section but will cover the highlights for you.

Mr. H. P. Crawford, Member, The Canadian Bar Association: Mr. Chairman and honourable senators, in thinking about what we should say in terms of the areas in the White Paper that gave us the most difficulty and how we have in some cases arrived at conclusions on how they should be dealt with, we decided that I should briefly refer to those areas and give you our conclusions. Our reasons for them are in our submission.

The first one, on which I think there is wide agreement, not only among the Bar but among the people in general, is that the distinction between closely held and widely held, at least in its present form in the White Paper, should not become part of our law.

The most perplexing problem for us has been that of integration, and we think this is the key structural issue. I emphasize "structural" as opposed to economic. The key issue is whether or not to pass on credit to shareholders for dividends without regard to underlying tax, or whether dividends will only carry credit if there is underlying tax. That to us is structurally a very perplexing issue. Our conclusion, after a lot of thought on the matter, is that the tax system should give credit for dividends without regard to underlying tax.

One can go through a detailed analysis of each source of untaxed earnings in a company and debate whether or not some credit with respect to those untaxed earnings should also be given to the shareholders so that there will be some tax lessened at the shareholder level also. If you look carefully at the foreign source earnings remitted to Canada, which have been taxed in foreign jurisdictions, or if not taxed because of incentive reasons in developing countries, etc. have been perhaps taxed at the lower rate, we think most of them should flow through. We think whatever incentives are developed for the extractive industries should flow through. After all, under the White Paper proposals you can do an election for your closely held corporation and flow through your incentives.

Senator Phillips (Rigaud): If I may interrupt you for a moment, I still do not know as a result of all this whether you are in favour of the integration system proposed by the White Paper or the retention of the present tax credit system.

Mr. Crawford: We are in favour of the system of credits without regard to the underlying tax. We say that whether you do it on a gross-up and credit basis or whether you do it with the present system really does not make that much difference. On balance we would prefer the credit system—the present system.

Senator Phillips (Rigaud): That is to say the present 20 per cent tax rate or a modification of the corporate rate as well?

Mr. Crawford: We have found appealing to some extent, even though it presents some problems, the Ontario suggestion that your credit flow through 25 to 30 per cent depending on the level of dividends.

Senator Phillips (Rigaud): How do you feel about the corporate rate in relation to the 20 per cent presently in force with the suggestion of a reduction in the corporate rate?

Mr. Crawford: I am sorry, senator, I did not hear what you said.

Senator Phillips (Rigaud): If this committee were to accept the suggestion that instead of the 20 per cent tax credit, there would be an increase thereof of 25 or 30 per cent, do you think that that should be accompanied by an increase in the corporate rate or a reduction thereof?

Mr. Crawford: It becomes a revenue consideration. Our basic approach is that the corporate rate should stay in the area of 50 per cent.

Senator Phillips (Rigaud): So you think if we retain the present system the tax credit should go up? We have to get a consensus.

Mr. Crawford: The thing that appeals to us is that probably on average about half—and I realize you could take no company and find this, but maybe it is a good general approach to take—that on average about half of your corporate tax is paid for by customers, suppliers, etc. Therefore on average we would be inclined to favour the 25 per cent credit. Our conclusion on the capital gains tax is that it should be structured separately from the income tax. One-half the capital gain should go into income and be taxed at marginal rates with the top rate being 25 per cent—working out at 25 per cent on the capital gain.

The Chairman: Did you say one-half?

Mr. Crawford: One-half of the gain would go into income and therefore if your top rate were 50 per cent, your tax on the gain would be 25 per cent. This is basically the U.S. system except that they have their top rate up to 35 per cent now on capital gains over something like \$50,000.

By saying that this is our approach, we would also have a holding period and I do not think that we were particularly specific about the holding period—whether it should be six months or a year. I think we would be inclined to elect for the six-months holding period. We would exclude, for the reasons given in our brief, principal residences and personal property. We were concerned about the implications of the departure of capital gains tax. Doing away with the five-year revaluation, we would be inclined to accept a deemed realization on death, except on transfers between spouses, with an adjustment or an integration, or however you want to look at it, in the aggregate of the gift or estate tax with the capital gains tax so that your maximum rate on them, that is on everything at that time would not exceed, say, 50 per cent.

The Chairman: May we revert for a moment. Talking about the capital gains tax and its application and a holding period in which it would be a capital gain and subject to a capital gain rate, and otherwise it would be in the income bracket. What would you recommend—that is if we simply let the time factor be the definition of what is a capital

gain or what is not, would you leave the settlement of the definition to the courts or would you attempt one?

Mr. Crawford: We would basically leave the problem of settlement to the courts.

The Chairman: But your time factor would be the definition itself.

Mr. Crawford: The time factor would mean that any gain realized within a six-month period would automatically be income even if under the existing case law it could be classified as capital gain. But beyond the six-months or one year you would revert to case law.

The Chairman: Then that throws out all the jurisprudence that you have.

Mr. Crawford: No. Beyond the six months you would determine whether it was a capital gain by reference to case law.

Senator Connolly (Ottawa West): You think the six-month period is a reasonable period?

Mr. R. H. E. Walker, Vice-Chairman, The Canadian Bar Association: I would prefer to take the view of the other members of the Board that it is deemed capital and deemed income. The general rules would continue, in other words, except that there would be a new rule drafted on.

Senator Phillips (Rigaud): Are we in order, Mr. Chairman, to put questions to the panel now?

The Chairman: I think the panel came here knowing what our practice is. They know that we ask questions from time to time and until we get some complaint, we can continue to do that.

Mr. Crawford: There are two further points that would take me about a minute and a half to make, Mr. Chairman. The first further point is on the International recommendation with respect to foreign income. As pointed out in our brief, we are very much concerned that the objective of negotiating a network of tax treaties by the 1974 date is completely unattainable, and on that basis we think it would be wrong if by 1974 a network of tax treaties had not been negotiated, to go forward on the basis that only those countries we then have tax treaties with can have the free-flow back of subsidiary earnings. We are particularly concerned about the implication for this in the developing country area where many of the developed countries of the world,

including Canada, are providing assistance in one form or another, and these countries are enacting incentive tax legislation to attract development, either in the form of reduction of taxes or tax parity, and if you cannot flow your earnings back to Canada in those countries without attracting further tax, in effect it means that the tax the developing country is sparing in order to attract development—the very thing we are doing through our International Development Corporation out of public funds—is being frustrated. We do not want to imply that we are not concerned about tax avoidance in this area. We are concerned about it. We think rules should be designed to the extent that the existing system will not do it to prevent the diversion of what would otherwise be Canadian source income through foreign jurisdictions. We are rather impressed by the paper that Mortimer Caplin delivered to you people on the problems of subpart F. We have reserved comment on subpart F until we see what the Department of Finance is going to come up with. We thought there was going to be a paper on it about four months ago, but we still have not seen it.

The Chairman: Mr. Crawford, before we get to that, would you agree that there are adequate provisions in the present tax laws to deal with tax avoidance?

Mr. Crawford: I think if the present tax laws were accompanied by the authority—I think this is in the institute's brief—for Canadian jurisdiction to require full disclosure from subsidiaries of Canadian companies and require Canadian companies to disclose the full activities of its subsidiaries so that the Canadian authority could find out precisely what was happening, most of the problems could be dealt with under the present laws.

The Chairman: Yes. Just to follow that up, if you have a parent-subsidiary relationship and the subsidiary is outside Canada, surely the returns and the financial statements of the parent company will disclose the information in relation to the subsidiary. You simply go from there. You know the proper person that you can put pressure on. You have somebody in your jurisdiction subject to your law.

Mr. Crawford: That is true, but what I am really saying is that the consolidated statement of the parent company will not prove helpful in terms of the sort of transactions these subsidiaries are becoming involved in and I think you have to recognize that this is part of this process. Maybe the Department of

National Revenue can do it under their existing authority.

The Chairman: Vis-a-vis any country with which we have a tax treaty there is a provision for the exchange of information in connection with tax avoidance and things of that kind.

Mr. Crawford: Yes. The difficulty is that in most of the countries where this has developed we have not had a tax treaty.

Senator Connolly (Ottawa West): Bill C-41 presently before the Government may also shed some light on this problem to disclose, if the bill should pass in its present form.

The Chairman: You are referring to the amendments to the Canada Corporations Act.

Senator Connolly (Ottawa West): Yes.

The Chairman: If it should go through. I will just add that qualification.

Senator Connolly (Ottawa West): I added it for you. Do you mind if I ask a question here? Quite apart from the technical aspects of this matter, about which Senator Phillips (Rigaud) has been asking, you talked about foreign countries where tax incentives were provided permitting dividends and other benefits to flow back to Canada. I would think that the group you have here would know something about some of these countries. Could you name some of the important countries that have these tax incentives, perhaps particularly in the resources industries? That is where they look to use it. Could you name some of the principal countries in which these tax incentives are given?

Mr. Crawford: I think, sir, you will find the Dominican Republic, where Falconbridge is talking about a \$200 million investment, is a developing country that has tax incentives or, at least, a much lower rate of tax on profits of corporations.

You will find, I think, tax incentives in New Caledonia, Indonesia and some of the countries of the Far East. I would refer you to the International Nickel brief which has quite a bit about undeveloped countries and their tax systems.

Senator Connolly (Ottawa West): What about the incentives and the depletion allowances in developed countries? Take Australia for example.

Mr. Crawford: We of the Canadian Bar Association have not gone into a prepared study on how the tax...

Senator Connolly (Ottawa West): I just wondered, since they are going to, perhaps, do away with unearned depletion, how many of the developed countries, who would be competitors of ours and so, of course, would be developed countries, are retaining these incentives.

Mr. Crawford: I think in general I should say that...

Senator Everett: Mr. Chairman, if I could interrupt here, Appendices B and C of the International Nickel brief give the facts on tax rates and depletion rates of, first, developed countries and, second, developing countries.

Senator Benidickson: Mr. Chairman, what we are thinking about is: there is a question of loopholes with respect to earnings or with respect to subsidiaries that are operating in foreign countries. This is something that the department is hoping to close up but they may be going too far and in doing so it may result in hardship and something undesirable from the point of view of taxing International Nickel.

Mr. Crawford: Yes.

Senator Benidickson: Then we have the other side of things, which Senator Connolly (Ottawa West) was developing, and which is in the International Nickel brief which we will be hearing later today, that is, information with respect to the relevant incentives between use of capital and the laws abroad and in Canada.

The Chairman: This is an entirely different question.

Senator Benidickson: Yes.

The Chairman: The question we are pressing on here has more to do with the tax havens and loopholes.

Senator Benidickson: Yes.

Senator Phillips (Rigaud): May I say that Senator Benidickson's position apparently implies that you do go quite far but not too far. I am sure he did not mean that.

Senator Benidickson: What I am thinking, Mr. Chairman, is that we have representatives of the lawyers of Canada here this

morning and I would have thought that no one could better tell us about ways of eliminating loopholes and tax havens, if that is the objective of the department, rather than a complete overhaul of our tax laws which creates unnecessary hardship on legitimate operations abroad.

The Chairman: This was the question I put to Mr. Crawford when I asked him whether he thought the present tax laws provide adequate provision and possess all the machinery that is necessary to discover. . .

Senator Benidickson: Generally we have been told that the discretion that exists in the Department of National Revenue is adequate to take care of most of the loopholes that may be complained about.

Mr. Crawford: I do not think we have been involved in any cases of loopholes in the international area but in terms of giving a legal opinion, we would always feel most uncomfortable if it was a tax by the department as to whether it would stand up and I think this is particularly true in the last two or three years that the interpretation of the courts have been upon the foreign versus subsidiaries.

The Chairman: Mr. Crawford, if you look at the situation. The word "loophole" itself is a misnomer. Either the law says something or it does not.

Mr. Crawford: That is true. Perhaps you could illustrate it in this way. Many of these plans depend for their validity upon a foreign subsidiary being non-resident.

The Chairman: Yes.

Mr. Crawford: And one test on residence of a corporation is where its *de facto* effective management is.

The Chairman: Or where it does its housekeeping.

Mr. Crawford: Or where it does its housekeeping. It would be hard to find many of these so-called non-resident companies that you would not be very nervous about going before the courts in terms of the court being very likely to hold the company was not actually a resident of Canada.

Mr. W. H. Carlyle, Member, The Canadian Bar Association: Mr. Chairman, there have been a number of cases recently where the court has been finding that the corporation

has more than one residence. I think this is a real weapon for the department if that is their point.

The Chairman: It may well be if the management and direction came from Canada the subsidiary is a sort of a figure and therefore this country cannot get at it.

Mr. Carlyle: Exactly.

Mr. Crawford: You know, the department thought that there was a loophole in the surplus stripping area for years. They ultimately took the case to the courts and so obviously the loophole ceases to exist, if you call it a loophole.

The Chairman: Are you going to say something at this point on the concept in the White Paper of passive income in this context?

Mr. Crawford: Our point on passive income is as mentioned earlier. We are rather impressed with the paper that Mortimer Caplin presented to you gentlemen. We suspect that it never occurred to the persons who drafted the part of the White Paper recommending passive income rules that they were designed because of balance of payments problems, and admittedly were not effective in that respect.

It is a good illustration of the global or overkill approach of the White Paper.

The Chairman: Did you say global or parochial?

Mr. Crawford: Global.

Senator Phillips (Rigaud): Are you still speaking of capital gains?

Mr. Crawford: I would now like to make our point with respect to trusts.

Senator Phillips (Rigaud): Have you completed your capital gains presentation?

Mr. Crawford: Yes.

The Chairman: Do you wish to revert to that, Senator Phillips?

Senator Phillips (Rigaud): Yes. Following questions put by honourable senators I feel we have left that subject matter incomplete. I would like to revert to it, Mr. Chairman. I refer to your suggestion that 50 per cent of the capital gains go into income and the other 50 per cent into the capital gains special category.

Have there been expressions of opinion within the profession as to whether capital gains should be segregated and subject to a flat rate, none of it being included in ordinary income? Or does the observation you make represent the consensus?

Mr. Crawford: The consensus in the Canadian Bar is twofold; many people are opposed to capital gains.

Senator Phillips (Rigaud): Yes, we are assuming one would be introduced.

Mr. Crawford: The consensus would be that the maximum rate should be 25 per cent. I could not say that there is any consensus as to how to accomplish that.

Senator Phillips (Rigaud): Would it be simpler, instead of dividing the capital gains in two parts and providing a special category of capital gains with a flat rate of...

Mr. Crawford: The flat rate troubles me, because you may be a person at a much lower marginal rate and maybe you should pay a lower rate than 25 per cent. That is the theory of taking half the gain, bringing it into income and taxing it at the marginal rate, whatever that may be.

Senator Phillips (Rigaud): That is true, it would produce that result. However, from an administration standpoint it would simplify the treatment.

The Chairman: Senator Phillips, it seems to me that if you are looking for the simplest way of applying capital gains tax it would be to abandon all your jurisprudence and simply apply a time factor. Any transaction, with certain exemptions, that produces a gain and has been held for six months or a year is subject to the fast buck, as I call it, the income tax rate. If it were held longer and disposed of, the fixed flat rate would apply. There would be simplicity and no litigation. This would be the case if it were held for six months. If not, it would fall within the fast buck category and become income.

Senator Connolly (Ottawa West): The witness seems to go farther and suggest that there could be people who make the capital gains income rate whose effective rate may not be 25 per cent. I gather the brief suggests that it should be the lesser of 25 per cent, or the effective rate.

Mr. Crawford: This is the U.S. system. You would pay less than 25 per cent under our

proposal if your marginal tax rate was under 50 per cent, because we are taking one-half of the gain into income.

Senator Phillips (Rigaud): I see your point, but we do not necessarily have to follow the American system, because we are introducing this for the first time. Why should we not simply start it off, even though there may be an element of inequity involved, retain our present tax system and introduce capital gains tax at a flat rate? We are dealing with an entirely different concept of income. Once you try to introduce simplicity, equity and logic when dealing with different types of income or profit, there are complications.

My second question is that there are some views expressed that in the introduction of capital gains tax it would simplify the system initially if we did not take the full tax on capital gains. Let us test it out in the form of tidbits, or even more, here and there by applying a capital gains tax only to the acquisition and disposition of securities.

Once we abandon integration we would go into closely-held and widely-held and simply apply the capital gains tax on securities and businesses. If a man has an incorporated company and sells the shares he is subject to tax. An individual in a partnership is subject to tax if he gets goodwill.

If the acquisition and disposition of shares, businesses and real estate, including investment income on real estate were included, period, for the present, how would the Bar react to that as a test until we see how we get along?

Mr. Carlyle: In my experience, apart from real estate and sales of businesses there is not really very much left that would be meaningful to the revenue.

In my opinion it would not be a tidbit, but a bite, if not the whole apple.

Senator Phillips (Rigaud): Do you think we would tend to be particularly inequitable if we did not follow the system of valuation dates on farms, which should not be taxed anyhow and roll-over on houses?

Mr. Carlyle: The Bar's view with regard to personal revenue is that it should be exempt.

Senator Phillips (Rigaud): So you would exempt certain assets by the time you have covered the category to which I have referred. Then there would be a series of increments. You are left, as the saying goes, with peanuts. Why not test it out on that basis to see how we get along?

Mr. Crawford: We can only give you personal reactions on this, sir; we cannot speak for the Bar.

Mr. Carlyle: The Bar's brief makes it clear that the home should be exempt, that personal property should have a ceiling of not less than \$5,000, so as to avoid the nuisance.

Senator Phillips (Rigaud): I am only trying to obtain a reaction to the partial approach.

Mr. Crawford: I do not think your proposal basically goes much beyond that in our report. It is probably taking the lid off personal property where we have just put a \$5,000 ceiling on it.

Senator Phillips (Rigaud): And you eliminate personal property in this \$5,000 and test it in things that are meaningful. As a personal matter in terms of administering the system, I would be inclined to bring everything in and make your exemptions rather than designating what you are bringing in. We might get the same end result.

Senator Connolly (Ottawa West): Would not the administration be easier the other way?

Mr. Crawford: I suppose on reflection it would not matter. You have the same borderline areas if your exemptions are the same. Either way you have fringe problems and you can never avoid those.

Senator Phillips (Rigaud): People cease to be perfectionists. You do the best you can by starting off and not trying to cover the waterfront.

The Chairman: What you are saying is that there is still merit in the trial and error effort.

Senator Everett: Mr. Chairman, I wonder if you might ask Mr. MacDonald, in dealing with Senator Phillips' suggestion, that the flat rate of separate tax be imposed. He has raised the point that of course this might impose a higher rate for capital gains on some income earners than they would pay on ordinary income. Somebody is shaking his head.

Mr. Crawford: What in effect would happen is that you would have a structure of marginal rates or progressive rates going up to 25 per cent.

Senator Everett: I am talking about Senator Phillips' suggestion to make the capital gains tax a separated tax at 25 per cent.

Mr. Crawford: It could in fact, if you are looking for perfection, occasionally result in an individual paying higher tax than if the gain was included in ordinary income.

Senator Everett: I beg your pardon?

Mr. W. A. Macdonald, Vice-Chairman, The Canadian Bar Association: I should like to interject. Looking at the proposed rate schedule, when you hit \$1,000 you are at 24.32 per cent. I think that all one is talking about is between the half inclusion and Senator Phillips' separate rate as the possibility that some people are in a fairly low bracket—you can see how low they have to be in order to be making capital gains of any significant amount.

Senator Everett: You would not want the poor people to make capital gains, you mean?

Mr. Macdonald: One would want them to make them, but if they were they probably would not be poor people. I have been told that by far the vast majority of capital gains are made by people in the 45 per cent bracket. You would have very few and in terms of simplicity this gain would have to be a personal view, because the Bar did not consider Senator Phillips' proposal. What we might have thought one cannot say, but a small exemption for annual capital gains might achieve a desire to take care of the small fellow who is making moderate gains. Then you would have a very simple system.

Senator Phillips (Rigaud): I think you could probably meet that by the suggestion that those having taxable income of net amount are not subject to capital gains tax in respect to profits made up to—you settle the whole problem that way.

The Chairman: Is it really a problem, Senator Phillips? If you are proposing only to tax half the gain—there is a concession there right away.

Senator Everett: Its not the point which has just been made that it is about equal either way? Under your system you have to have a markedly better averaging system than proposed under the White Paper? Is that not so?

Mr. Crawford: Yes.

Senator Everett: What do you think of an averaging system instead of using what I think you suggested, a block averaging, the averaging of the effective rate of tax for the last three years? This would tend to fix a

maximum of 25 per cent or lower the tax markedly to low income earners who enjoy capital gains.

Mr. Carlyle: Our present section 36 of the Income Tax Act provides such an averaging remedy. The effective tax rate over the last three years—speaking for myself—I feel is an excellent formula compared to...

Senator Everett: I am using this averaging system for capital gains. How do you think it would work in the case of capital gains?

Mr. Macdonald: In order to establish a capital gains rate?

Senator Everett: Yes.

Mr. Macdonald: Not to average capital gains, but to establish a capital gains rate?

Senator Everett: In effect, that is what it would do.

Mr. Crawford: I think that would probably be quite feasible.

Mr. Walker: It would have the advantage of having people move their capital gains from one year to another in order to gain the most possible benefit out of it. You are quite right that it would in effect remove a loophole.

Senator Everett: That is right. It would have that advantage and impose a maximum of 25 per cent. It would be simple to calculate because it would be effective rates and it would lower the rate to those whose income is below the plus \$24,000 level.

Mr. Macdonald: Could I interject on one aspect that flows out of Senator Phillips' comment which may be significant. On the half inclusion in gains in income one presumably has the corresponding half inclusion of losses in income. Unless we have something like the United States system of restricting the deduction of capital losses from capital gains you could have some rather unusual revenue implications which would be avoided by Senator Phillips' proposal.

Senator Phillips: I think you are hitting the nail on the head and I congratulate you because you agree with me. It indicates the confusion which would arise. If you had a separate category we would simply deal with the subject matter of the capital gains and with the deduction of capital losses we would avoid all sorts of problems. As I indicated before with regard to taxpayers, we now treat special categories by way of incentive legisla-

tion. One should not be so concerned with the desirability or necessity of trying to get it into our taxable income system. Let us create our own category and deal with it in a simpler form.

Mr. Crawford: We find your suggestions, Senator Phillips, very appealing.

Senator Flynn: Mr. Chairman, assuming that we have a tax on capital gains on realized profit on shares, I was wondering whether the witnesses have considered the problem which was raised once before, of the inclusion in this gain of earned surplus of corporation taxes. I suggest that if you retain a part of your surplus, that this will have the effect of increasing the price or the value of a share and therefore in taxing the capital gain there you would be really taxing income. I wonder if this does not mean double taxation in the end, because when this is going to be distributed it is going to be taxed again in the hands of the shareholders.

The Chairman: You may take care of that if you only tax half the gain.

Senator Flynn: Yes, but earned surplus is only a component of the capital gain in this field and it seems to me that there is double taxation there. I do not know what would be the effect. Would we not have a result that the corporation would tend to distribute the whole surplus rather than retain it, if eventually it is going to be taxed twice.

The Chairman: You have a choice at the present time. You can take a dividend or sell your share.

Senator Flynn: Yes, but if you sell your share the part of it that is really represented by earned surplus has already been taxed, it has already been subject to corporate tax. I wonder whether this would not defeat the idea of getting the share, if you are getting a surplus and retaining the working capital within the corporation.

The Chairman: Except that if you only tax half the gain you are giving some recognition that there is half of it that should not be taxed and it may be that that is what you are looking at.

Senator Flynn: It may be. It seems to me that some capital gains are really not capital gains but are really earned surplus or income which may be taxed twice.

The Chairman: That is a factor in the price.

Senator Molson: On these discussions about capital gains, you frequently alluded to taxing 50 per cent of the gain. It seems to me that there has to be a good rationale for picking that number, that percentage, that par.

The Chairman: The White Paper does it.

Senator Molson: Yes, it does it in one place and not in the other, but we have to have one that can be stood up across the border.

The Chairman: I take it you have not anything more to add on that point.

Mr. Crawford: Senator Molson, there are two comments. To some extent you can justify a reduced rate of capital gains tax to offset inflation. To some extent you can justify it, perhaps, because of the point made previously that your earned surplus part of the increasing value of the shares is opposed to the goodwill part that has been taxed at the current level. We also come into the very great argument that we in the Canadian Bar are not able to contribute so much on the importance of investment in this country and incentives for growth, and whether or not you therefore justify a reduced rate on this type of an increase in wealth because of the desirability, in a developing country such as Canada that needs investment, of retaining incentives in this area.

The Chairman: It is a strong factor, you must admit, to retain in the hands of the people as much of their savings as possible.

Mr. Macdonald: Is there not one aspect, senator, that the United States has a rate that in most cases does not exceed, roughly, 25 per cent and this seems to be a compelling factor in the authors of the White Paper. It seems that what may be creating a lot of the problem is that they apply that 25 per cent rate to about 85 per cent of the business and decide to apply a different rate to the remaining 20 per cent. I think we made it clear that you have to take one and stick with it that, in order to avoid a lot of shifting around.

Senator Molson: I think they are all very good points, Mr. Chairman, but I think it is very necessary for the argument that the 50 per cent be based on some form, some principle, and does not really emerge as being a nice round figure and this is really where the points that Mr. Crawford has made are very valid and very helpful.

Senator Carter: Could we get the Bar Association's reaction to the principle that in

Canada our whole tax structure should not be too far out of line with that of our nearest competitor?

Mr. Crawford: We would agree with this, it is particularly illustrated in our submissions with respect to the extractive industries. You have to concede, however, that we maintain the same welfare benefits in this country with lower incomes and therefore it is hard to avoid the tax, if we are going to have to pay a somewhat higher tax, but we feel very strongly that the discrepancy should not become too great.

Mr. Macdonald: I think we feel strongly that it should not be too great in those areas of greatest competitive sensitivity. There are some areas more sensitive to international competition than others and I think we have to be most careful in those areas that are sensitive, which would mean capital, presumably, and mobile people.

The Chairman: I think that is a good point.

Senator Everett: I would like to ask some questions which relate peripherally to capital gains. This concerns the valuation of assets on valuation day, which I think will be very important in establishing capital gains in the next few years. The Bar Association has made several suggestions which I would like to go through with them, if that is possible.

The Chairman: Yes.

Senator Everett: For the purposes of putting them on the record and also to get their explanation of their suggestions.

The Chairman: What page are you referring to?

Senator Everett: I am not sure. I will find it as I go along. One of the suggestions concerned the valuation of widely-held company shares. In any event, what you suggest is that the taxpayer be given the option of valuing at cost or market, except for the purposes of capital losses. Would you like to enlarge on that?

Mr. Carlyle: The suggestion in the brief is tantamount to a situation where the cost is actually less than the V-day value and the recommendation was that there be no capital gains until the original cost had been recovered, that there be no loss recognized unless there was a below valuation day value. That is the proposal.

Senator Everett: So that a man who bought a share for \$50, that on valuation day was worth \$30, could choose for the purposes of subsequent gain either the \$30 or the \$50?

Mr. Carlyle: No. He would not be taxed on any gain until he recovered the \$50, but he would have not capital loss unless it was below the \$30.

Senator Everett: I see.

Senator Connolly (Ottawa West): This is complicated. Would it not be easier, if we are going to adopt Senator Phillips suggestion and have nominated shares—does not the question of valuation day go out the window?

The Chairman: It would not go out the window, Senator Connolly. You have two sets. If after this becomes law, if it ever does, and you bought a share, that would be your cost, but this is to establish the valuation of what you have when valuation day comes along.

Senator Connolly (Ottawa West): I realize that. What I am getting at is this; if you adopt the simple procedure of buying a share at say \$50, and then it goes down to \$30—and there is no capital gain and no valuation day—and finally it rises to \$40 and you sell it. You have still made a \$10 loss. Why do you need a valuation day?

The Chairman: Well, you need a valuation day because, first of all, this is not supposed to be retroactive. So what you must do on valuation day is either take the value on that date, or—and I think they have to add something else—the cost, whichever is the higher.

Senator Connolly (Ottawa West): Certainly it is a better proposal than the White Paper proposal, but it seems to me that it would simplify things very much if you would do away with valuation day and say if and when the act becomes effective and Royal Assent is given, that from then on capital gains are taxed at the flat rate, and if you make a capital gain thereafter, you apply, say, the 25 per cent rate or something like that.

The Chairman: You are holding out for the historic cost with no valuation day.

Mr. Macdonald: If you took the case of somebody who bought shares 20 years ago at \$10 and they are now worth \$100, and when the law came into force you sold at \$100 or \$110, you would be taxed on the whole gain over all that period.

Senator Everett: But the valuation rule that Senator Connolly refers to would only apply to the shares of public companies.

Mr. Macdonald: What would happen is that everybody would want to sell and rebuy in order to avoid being caught with a low historic cost.

Mr. Carlyle: Mr. Chairman, it works the other way too. Using Mr. Macdonald's example, if you bought shares ten years ago for \$100, they might now be worth \$10.

Mr. Macdonald: But our proposal covers that.

Senator Everett: Going on from there, you have made the suggestion regarding valuation of shares of public companies. Now do you not think that under the rules of valuation as you have suggested them, that there is an element of goodwill included in the share price of shares of public companies?

Mr. Crawford: I think undoubtedly there is in most cases.

Senator Everett: Then we move to the problem of valuing shares of companies or partnerships for which there is no ready market such as there is for the shares of a listed public company. Will you agree that goodwill is taxed retroactively either by virtue of the fact that the owner of shareholder or partner is forced to value the underlying assets at their market value, and to pay the difference between that price and the goodwill price as a capital gain if he subsequently sells, or alternatively that he is not entitled to creditable tax for the amount of goodwill. Is that a fair assessment of the intention of the White Paper or the operation of the White Paper?

Mr. Crawford: I think we agree that there could well be an element of retroactivity in the valuation of goodwill, and we agree that your statement is correct. If you accept the theory of the White Paper that by making the cost of goodwill deductible, you automatically make it more valuable and therefore if sold in the first year after the system becomes effective, a certain percentage of the gain should be included in income at a higher percentage and the same in the second year, etc. There is a certain amount of logic to that. It does not take into account many circumstances, however, where there will be goodwill that will be taxed retroactively.

Senator Everett: That goodwill that will be taxed will be for the most part the goodwill that existed prior to valuation day, and is this not a clear case of retroactive taxation?

Mr. Crawford: If you assume as the White Paper does, and I am questioning their assumption, that the value of goodwill will go up to a purchaser in direct ratio to what he is going to be able to deduct—and by the way they do not take into account that the deduction is at the rate of 10 or 15 per cent over many years; they still assume it is deductible immediately—but if you assume that the value will go up in direct ratio and forget about discounting the deduction over the years, there is logic in what they say. But we question the assumption.

The Chairman: Senator Everett have you ascertained as to whether Mr. Crawford personally or speaking for the Canadian Bar Association supports the proposals as to goodwill in the White Paper.

Senator Everett: I am coming to that, Mr. Chairman. I think we should agree on terminology before I ask how they propose to rid us of this evil. Just to pursue that point, it would seem to me that even though there is an element of increase by reason of deductibility of goodwill in the hands of the purchaser, nevertheless when you refuse creditable tax and all that difference between the goodwill value of the shares and the market value of underlying assets, there is incipient in that a tax on goodwill that existed prior to valuation date.

Mr. Carlyle: Yes. The Canadian Bar is not in agreement with the proposal in the White Paper on taxing goodwill. We believe that it is retroactive, and not only is it retroactive, but it also tends to tax goodwill that may never be realized. You made reference to the law for creditable tax, and that is the very point I am directing my remarks to. The federal tax is denied to a particular taxpayer and he may never sell his business, or when he comes to sell his business, the goodwill may no longer exist.

Senator Everett: Well, let us take a specific case, if I may, so that anybody reading the record can understand what I am talking about. Let us assume a company had assets with a net book value of \$200,000. The market value of those assets is \$400,000. However, the company was enabled through the use of those assets to earn \$200,000 a year before taxes. I think you would agree that it

probably would have a value to a purchaser of somewhere in the neighbourhood of \$1 million—five times the earnings, would not be unreasonable. Now if the owner of those shares on valuation day valued them at \$1 million, it seems to me that on the operation of the White Paper, and I wonder if you agree, that the shareholders of that company would lose creditable tax to the extent of \$600,000. Alternatively, if the business were sold, there would be a capital gains tax imposed on the \$600,000 essentially.

Mr. Carlyle: On your first assumption, the loss of creditable tax applies even though the business has not been sold and the goodwill not realized. This is one aspect that is not really fully appreciated. Noto only is it retroactive, but it is a tax on unrealized gain.

Senator Everett: So, you make a very, very good point; if the owner of the business sells, he pays a retroactive capital gains tax, and if he does not sell, he pays the same tax because he does not get the creditable tax on the amount of the goodwill.

Mr. Crawford: Just to put it on the record, senator, we deal with this question specifically at pages 27 and 28 of our submission.

Senator Everett: In that regard, could you give us now the proposals of the Canadian Bar Association in reference to goodwill.

Mr. Carlyle: You will find it at page 29 of our brief.

The Chairman: Yes.

Mr. Crawford: Would you just give us a short precis of it, please, and state the proposals that we have in the brief.

Mr. Carlyle: We state here:

We are opposed to the special treatment being proposed for taxing the proceeds of the sale of goodwill of a business after valuation day. We submit that if the sale of such goodwill is to be taxed, only the net gain realized over its value on valuation day should be taxed. We know of no convincing reason for treating goodwill differently from any other asset. The fact that the goodwill of a business may have resulted partly from past efforts or expenditures does not justify retroactive taxation of goodwill existing on valuation day. Furthermore, if a taxpayer actually purchased goodwill before the beginning of the new system, there would, under the proposals, be no deduc-

tion permitted for his cost of acquiring such goodwill or its value on valuation day, but upon selling his business he must include in his income a percentage of the gross proceeds from the sale of goodwill.

In effect, we say that it should be taxed on realization with costs deducted from the amount of the gain.

Mr. Macdonald: May I interject and go back to something that was discussed earlier with Mr. Crawford? In reference to the assessment which also appears in the reference to mining rates, it seems that the authors of the White Paper appear to think that some provisions of the White Paper will make some assets more valuable and that therefore they should tax that away.

I think our attitude is, first, that you cannot isolate a single provision of the White Paper and make a decision that that single provision increases the value. It may well be that the White Paper as a whole, if it were introduced, may reduce many values, and that is really what we are saying. There is no way of knowing or ever being able to isolate an element or some modification, of a single value that existed before the White Paper, from the existing value on the day after. This is just a hopeless exercise for which we do not see any basis in reality to do it in any fair fashion.

The Chairman: Does that mean that we can strike out the White Paper proposals in reference to goodwill in your view?

Mr. Macdonald: We are suggesting, first, that there should be no deduction for goodwill.

The Chairman: My question went further.

Mr. Macdonald: I think we would want to read the White Paper, to read what all the references are. You may well be right, but that is what we are saying.

The Chairman: I am not putting it forward on the basis of whether I am right or not. I am asking you whether you are suggesting or would suggest that the way we should treat it is to strike out any reference to goodwill in the White Paper proposals?

Mr. Crawford: I think in fairness, senator, you have to recognize that there is a problem. If, under the White Paper proposals, capital losses are deductible, you have to have some system to deal with what you call the credible tax area or the goodwill area.

We are quarrelling with the system for dealing with this. We suggest at the bottom of page 28 of our submission—and this is on the assumption that other provisions of the White Paper are adopted along with the credible tax system—that consideration be given to treating after-tax income when realized—I emphasize that—as credible tax earnings in the same manner as the pre-effective day surplus so that such amounts are treated as contemplated by the March 19 technical study.

Senator Everett: On that particular point it is not clear in that technical study and in the White Paper whether the pre-existing surplus that was derived from capital gains should be taxed at 15 per cent or whether, as at present, once undistributed income has been removed, it should move out tax-free. Can you tell me what your suggestion is?

Mr. Crawford: You have to look at the whole series: prior effective date and surplus problems; post-effective date and non-taxed surplus problems.

There are quite a number that are not dealt with and even the March 19 technical study is ambiguous. I think the concept should be that only that classified as undistributed income, if it were realized prior to the effective date, should be treated as part of the surplus.

Now, this is obviously subject to change when you introduce the capital gains tax.

Senator Everett: But the rest would move out tax-free as it does today.

Mr. Crawford: That is right.

Senator Everett: Thank you very much. Just in closing, Mr. Chairman, you asked a question about goodwill. I think the idea of the brief is to treat goodwill as land so that, in effect, there would be no reference to it at all.

The other point I would like to make is that both the Canadian Bar Association and the Canadian Institute of Chartered Accountants are two groups who are probably more knowledgeable about our tax laws than any other single group...

The Chairman: Except maybe this committee.

Senator Everett: ...with the exception of this committee, are opposed to the White Paper proposals on goodwill and believe that it should be treated as land, and are opposed to the direct effect of taxation on the value of goodwill.

The Chairman: Now, what is the next item you have, Mr. Crawford?

Mr. Crawford: I should like to put on the record, Mr. Chairman, one matter dealt with in our brief which, I doubt, has been dealt with in much detail in any other brief, and that is the problem as to the taxation of ordinary trusts.

Again you have an illustration of the global approach. The White Paper starts on the basis that there have been abuses in accumulating income in ordinary trusts and the splitting of income through ordinary trusts. We comment that this is probably right, but we think that the authors of the White Paper have overemphasized what has taken place and have not taken into account the tremendous number of trusts that exist in this country because of trusts that are created in wills and inter vivos situations. They propose to tax all the accumulated trust income at a flat 50 per cent rate which we feel is simply unfair in many cases.

We have worked out a rather elaborate proposal, commencing at page 36 of our submission, dealing with trusts. We realize there are a lot of problems involved, but we would like to bring it to the attention of this committee.

The Chairman: We have had some representation in connection with trusts and, I think, trusts of a nature that have been set up with foreign capital, so we are aware of the question now. Would you care to put in a very brief way how you propose that this situation should be dealt with?

Mr. Crawford: I would like Mr. Fuke to deal with this question, bearing in mind that he does not have a microphone.

Mr. J. M. Fuke, Member, The Canadian Bar Association: Mr. Chairman and senators, our proposals are basically these: the trusts we are primarily concerned about are the trusts that are created by man in his will where he leaves a life income to his widow and the remainder to his children. This type of simple thing, which has no tax avoidance nor tax considerations at all. It is merely sensible estate planning.

Our proposals are this: the income that is received by trust that is paid out to beneficiaries in the year of receipt is taxed, of course, in the hands of the beneficiary, as is the present proposal.

Any income that is retained would be taxed in the hands of the trust. The rates, though,

would not be 50 per cent, which is the highest rate possible and that proposed in the White Paper, but would be referable to the ultimate beneficiaries. Therefore, if income or capital gains are retained and will ultimately be going to the children, they should be taxed at rates referable to the rates the children would have paid had they received the gains in that year. It would give a much more equitable result.

The first tier of taxation, as we refer to it, hopefully would be the only taxation that would be applied to the trust income. However, in complex trusts where it is not possible to ascertain who the ultimate beneficiaries are going to be, we envisage that there would have to be a second tier of taxation.

The first taxing would be treated as being a withholding of tax and in the ultimate distribution there would be a settlement of the tax score.

The Chairman: Or a refund?

Mr. Fuke: Yes. The White Paper does not mention the point that all capital gains received in a trust are by definition of the White Paper treated as income.

If we had a situation where a man had set up a trust in his will where the income went to his widow and the capital was kept for the children until her death, any capital gains realized in the trust during the widow's lifetime which the trustees had no authority to distribute would be taxed at 50 per cent, even though the children's rate of taxation would be substantially less.

The Chairman: But if you consider the suggestions made to you by the committee this morning, any capital gain in the trust would pay a capital gains tax at that time.

Mr. Fuke: Yes, if you take the proposals such as are made by Senator Phillips, the hardship problem would not exist.

We are concerned with the effect if the White Paper proposals are implemented...

The Chairman: What conflict, if any, do you see if the White Paper proposals were implemented with regard to the widow's position under the estate tax?

If the husband sets up a trust for the widow, there is no estate tax at that time. Do you suggest that the White Paper proposal is that there is an income tax?

Mr. Fuke: It would be an income tax.

The Chairman: On gains?

Mr. Fuke: On gains, yes. On the trust assets during the period that the estate was being administered.

Senator Beaubien: Supposing there was a capital loss in that period, how do you suggest that it should be treated?

Mr. Fuke: A capital loss during the widow's lifetime?

Senator Beaubien: Yes, would the beneficiaries then get a refund or a tax credit because of the loss, or does this business just work one way?

Mr. Fuke: I would think you have to carry that forward and again have a settlement at the time of ultimate distribution.

The Chairman: The point first of all is that if there were a capital loss you would not pay anything at that time.

Senator Beaubien: You have to pay on capital gains. Do you recover if there is a capital loss? The two have to go hand in hand. If a person died five years ago and the widow happened to die today, there would be a very nice capital loss.

The Chairman: You may wish to carry that one back, Senator Beaubien.

Senator Macnaughton: Your specific criticisms of the White Paper scheme are clearly set out on page 38 of your brief.

Do you wish to expand, or is that your stated case?

Mr. Fuke: They are fairly well presented there, sir.

Senator Benidickson: You might read that paragraph into the record.

Mr. Fuke:

Our specific criticisms of the White Paper scheme are:

(i) The proposed rate is unfair for most trusts, and punitive of trusts generally.

(ii) The undeveloped idea in the White Paper referring to the relieving provisions only in the case of testamentary trusts and only where the testator was relatively poor is an insufficient gesture towards equity.

(iii) It is not the remaindermen only who will suffer as the result of the overpayment of tax, it is the life tenant, whose future income will be cut down when a proposed rate is inappropriate by

the reduction of the amount available for investment in the hands of the trustees.

(iv) There is no mention of credit for corporation tax paid although we assume this will be allowed to the trust nor is there mention of a deemed realization for capital gains on distribution of the trust although we assume this will not be the case.

Mr. Crawford: The other point we wish to highlight and might have mentioned earlier when we touched on international, relates to the further difficulty there will be in negotiating treaties because of certain of the proposals in the White Paper.

We have particularly in mind the proposals as to how non-residents would be taxed on their capital gains in all cases as if they were residents, except in the case of widely-held companies when they would have to own a holding of more than 25 per cent.

Our concern is that this is contrary to the tax systems of most countries with which Canada would be negotiating or re-negotiating treaties. We think it is going to throw a great stumbling block in the way of negotiating treaties, in addition to being impossible to enforce. A foreign company or some entity in a foreign jurisdiction will be interposed between yourself and your Canadian holding so that you can always have your realization of a non-Canadian asset. That may not always be possible, but it will be done in many cases.

The Chairman: There are other problems, but, having regard to your view on integration and some of the views that have been expressed here, they would disappear if integration disappeared.

I am thinking, for instance, of Canadian-based multinational companies who would likely be adversely affected on the flow through of income returning to Canada.

Mr. Crawford: Yes.

The Chairman: It may destroy the benefits and advantages of such an operation.

Mr. Crawford: This is a perfect illustration of consideration of tax laws in isolation from many other very important considerations.

If it is considered to be important to the future of Canada that its companies become multinational and take investment opportunities abroad, some of the implications of the White Paper in the international area must cause concern.

The Chairman: A number of export associations appeared before us. They were very concerned about what would happen in the export market as a result of some of these recommendations.

Senator Molson: There is a suggestion about the status of taxpayers during a period when treaties are being negotiated or renegotiated. It has certainly been the experience that very often these take a considerable time. What happens in the interim if there is a very long hiatus during the periods of negotiation?

Mr. Walker: The Canadian Bar Association brief refers to that and suggests that some international provisions should be deferred until we know that we have a sufficient number of international treaties. Otherwise there would be some grave inequities.

The Chairman: In the ordinary way if the law of the land imposes a tax on a certain basis and no tax treaty has been negotiated, you have to pay unless you can provide for some deferment.

Mr. Crawford: The White Paper refers to the date of January 1, 1974 as the hoped for date. They are not specific.

Mr. Walker: In some situations it is January 1, 1971.

Mr. Crawford: We obviously think that we probably will not even have our treaty renegotiated with the United States by then. If these proposals are implemented January 1, 1984 might be a more feasible date.

The Chairman: Are there any other questions? I reserve a comment that almost came out. There have been many hopeful dates but as time passes they seem to get pushed ahead, so I am not sure, even now, that the first of January 1971 is a hopeful date—not a date to be hoped for, but a hopeful date.

Senator Everett: I am a little confused by the suggestion that the Bar Association makes on depletion, contained on page 32 of the brief.

The Chairman: I thought we might do better on that with the International Nickel Company, the next witnesses.

Senator Everett: I bet we will. That is no reflection on the Bar Association.

The Chairman: While we are waiting for them, we can have some further questions.

Senator Everett: You suggest on page 32, in item (b) that we continue as a floor the existing amount of depletion, but that we adjust the reduced rate to an appropriate percentage of gross profits. So, in other words, we move from a net profit depletion to a gross depletion. Have you any idea what rate is appropriate?

Mr. Clark: No. We have not considered rates here at all.

The Chairman: You remember, Senator Everett, that Gulf suggested a 20 per cent depletion rate that would really be unearned depletion, such as you have now, and then that you would have a one for two, the earned depletion.

Senator Everett: That is correct, Mr. Chairman. Then, at the top of page 33, in a subparagraph (iii) you suggest that the limitation of 33½ per cent of production profits should be calculated before the deduction of eligible expenses rather than after. Is not that a form of gross depletion?

Mr. Clark: Yes, I think it probably is.

Senator Everett: So, in effect, if you took those two items together, what the Bar Association is suggesting is a gross depletion of 33½ per cent. Is that correct?

Mr. Clark: Yes, that is correct.

Senator Benidickson: I would like to deal with one or two things in this admirable brief that perhaps have not been emphasized by others in the long course of our hearing. I am thinking that this brief says more than most others, on the subject of gifts and bequests. I refer to page 17. Most of that, I think, should be emphasized—as we did a short time ago—having the reporter just take it and put it specially in the minutes of our examination.

The Chairman: Where would you start, senator?

Senator Benidickson: I would start at the phrase "We have the following comments". Those are rather brief and are separated. You refer there particularly to items to which I would like to call attention, that is, the ambiguity about taxation as proposed in the White Paper with respect to a gift to one spouse. Then, there is the other subject that we have not heard too much about, taxation with respect to inter vivos charitable gifts.

The Chairman: Will that be (a), (b), (c)?

Senator Benidickson: Yes.

The Chairman: That will be inserted at this point.

(The extract is as follows:)

Gifts and Bequests (3.41 and 3.42):

We have the following comments on the White Paper proposals relating to gifts and bequests:

(a) It appears that it is intended that the donor of a gift is to be subject at the time of the gift not only to gift tax but also to a capital gains tax.

(b) The White Paper does not specify that the gift tax will be added to the cost base of the donor in ascertaining his capital gain as is recommended in the White Paper for bequests.

(c) The imposition of a capital gains tax with respect to a gift to the spouse of the donor appears to be contrary to the spirit and intent of the present policy of the Government as reflected in the 1968-69 amendments to the Income Tax exemptions gifts to spouses from gift tax.

Senator Benidickson: Then there is another statement that we have heard very little about. It is item (c) of the recommendations, with respect to taking into account provincial succession duties.

The Chairman: That item (c) will be inserted at this point.

(The extract is as follows:)

(c) It is not clear whether the cost base as assumed by beneficiaries of an estate is intended to take into account provincial succession duties and it is recommended that such duties form part of such cost base.

Senator Benidickson: The Canadian Bar has something rather different than the bulk of the recommendations that we have received with respect to the taxation of small businesses. Did that come up while I was out of the room?

The Chairman: No.

Senator Benidickson: On page 26. We have here something rather different. We have something specific, in that the Canadian Bar Association suggests that to assist small businesses, we do not go along with the proposals in the White Paper, that the preferential treatment that they now receive be completely

eliminated, but you propose that there be a deferral period of five years for businesses whose taxable income is less than \$35,000.

The Chairman: Does not the White Paper have any deferral period of five years?

Mr. Clark: That is on the present system.

Mr. Fuke: That is a transition period, as distinct from a permanent one.

Senator Benidickson: You want complete deferment for the period of five years, and then that that be covered gradually over the following five years. That is rather different.

The Chairman: The comment that has been made on that, even by some of the senators, is that the real need of small businesses is retained earnings as their only source of capital and it is not good enough simply to defer for awhile, that there should be a method under which they are able to retain more of their earnings.

Senator Benidickson: On pages 12 and 13, we have something which has not been emphasized too often by others, that is, the point of averaging.

The Chairman: Were you in then? We talked a little bit about that earlier?

Senator Benidickson: I am probably satisfied with what is on the record on that, because I was out at the time. I am interested particularly in this. We have been getting explanations of anything in the White Paper that has the effect of a retroactive tax, and I see that you use that phrase on page 12 under the outline on unfairness, on three grounds. On the second ground you refer to the retroactive effect. Perhaps that should be expanded very briefly.

Mr. Carlyle: Yes, that consideration of putting their money aside to a pension fund for those who would be retiring within the first five years of the new system, in fairness, the proposal under the new system is that the top rate will gradually come down over the five years, so that at some time within that five years they will be subject to a higher income tax, something higher than the 60 per cent or the top rate of 50 per cent.

Senator Benidickson: That is just what I wanted on the record.

The Chairman: The simple way of saying it would be that, if you put your money in and got exemption when taxes are lower, then

you run into this very inflated rate when the money comes out in the lump sum.

Are there any other points, Mr. Crawford.

Mr. Crawford: I do not think we have any other points.

Senator Molson: There are two professions that again express an opinion more valuable to us, in answering a question, than any others—the members of the Bar and members of the Chartered Accountants Association. I would like to ask the views of the members of the Bar what their opinion is of the feasibility of the application of the White Paper from the point of view of Government administration, corporation returns and the individual complying with the requirements of the act as it would be.

Mr. Crawford: We are concerned about the administrative problems that would develop, particularly in terms of looking at the problems that developed in the United Kingdom a few years ago when they introduced a new system, which was not as new, by the way, or not as all-embracing as the system proposed in the White Paper. Primarily it was a capital gains tax and a corporate income tax which was introduced. We were interested in how the system broke down because the lack of assessors and lack of staff to handle it. We are also concerned about the feasibility of administration, the problems of creditable tax, the problems of the stalemating of the creditable tax on corporate earnings. We have not tried to prepare a list, but one could go on at great length. This has to give one concern.

Senator Molson: But, from the point of view of a corporation, is this not going to take an enormous amount of additional work, involving more cost, more time and more staff?

Mr. Crawford: Inevitably it will make it very difficult for the small corporation and the smaller businessman who to date has not had to concern himself to any great extent—well I suppose we could say he has had to concern himself over the last few years to an increasing extent with administration matters and tax matters, but the scale will double overnight.

Senator Molson: And he will have to rely on professional assistance to a much greater degree.

Mr. Crawford: Undoubtedly.

Senator Molson: Then, what about the individual who is faced with the rules as contemplated under the White Paper? Do you foresee the bulk of the Canadian taxpayers being able to sit down and fill out these forms and mail them in with a cheerful smile, or do you think that he might get rather bogged down?

Mr. Crawford: Undoubtedly, particularly in the earlier stages, he will get bogged down too, unless his sole source of income is salary or something of that nature. In that event there should not be much change from the existing system. But then there will be capital gain, personal residence, property valuation problems, etc.

Senator Molson: Do you think there is any danger that if the provisions of the White Paper become law, that the system would become unworkable because of the demands on all these people we have just mentioned from the administration to the individual? Is it possible that the whole system could break down and that there would be a chaotic condition.

Mr. Crawford: There would be a great backup in terms of the timing in dealing with assessments or reviewing tax returns. I would not like to put a number of years as to how much longer the meantime would become, but it would become substantial at least for some period of time. It could have serious implications, but I would not want to say that these systems would break down.

The Chairman: No matter how efficient the computer system may be, you still have to put the right information into the computer, and it is going to be a question of getting the right information.

Mr. Crawford: Correct.

Senator Molson: And it gets to the point where you cannot push the individual any harder. He may not be physically able to get his return made up and sent in in time.

Mr. Crawford: We think there is great merit, although it is not specifically in our brief—at least I am speaking personally—in what I refer to as the Ontario counter proposals where they recommend implementing the changes in stages—whatever they may ultimately be. Mr. Walker would like to add something to this.

Mr. Walker: On the same subject, some of us feel that there would be a serious delay in

the area of corporate acquisitions, the purchase and sale of ordinary businesses because no one will know where they stand for so long because of the necessity of valuing shares and assets when this takes place, and with reference, of course, to the valuations which existed on valuation date, coupled with this long period of working in already mentioned by Mr. Crawford. It means we will not get answers for ages after these transactions have taken place. These may be very, very difficult to conclude.

Senator Molson: Even rulings from the Department might become rather scarce.

Mr. Walker: It will be very hard, and they can hardly be blamed because of the quantity of questions that will swamp them at this time.

Mr. Fuke: Another area, Mr. Chairman, that has not been touched on is when you get a system where you have a full integration benefit and half integration benefit or where some shareholders such as non-residents will not get the benefit of these incentives and others will, and where you can get a capital gains rate at 25 per cent and others at 50 per cent; there will be a whole area of new activity by taxpayers to move themselves into the most favourable relationship to lower capital gains rates if they sell, or to be in a position to roll over capital gains over from one generation to the next. Then getting out of the public situation to a closely-held situation, I think that would be a whole area of massive taxpayer activity to take advantage of the best arrangements under an integration—closely-held—widely-held differentiation.

Senator Cook: We would move from a system where we have a certain amount of certainty to a system where we would have uncertainty for a period.

Mr. Crawford: That is one point we might put on the record fairly clearly. When it was being discussed in the Canadian Bar—the White Paper proposals—it had become very clear to us, and I think this was in evidence, that the problems of the tax planning, tax avoidance, loopholes, if you like, are not going to be behind us. There is going to be whole new structures with all the problems Mr. Macdonald has indicated going forward in other areas, etc.

The Chairman: Any other questions?

The Chairman: Honourable senators, the next brief is that of International Nickel Company. Mr. Wingate is here and he is Chairman of the Board. He is going to make the opening statement and introduce the panel.

Mr. H. S. Wingate, Chairman of the Board, International Nickel Company: Mr. Chairman, honourable senators, I and my associates very much welcome this opportunity to appear before your committee and to discuss the impact of the White Paper proposals on the mining industry and, of course, more particularly on our company, International Nickel Company.

The delegates will participate in endeavouring to answer your questions with me relating to our submission, copies of which you have. To my right is Mr. J. C. Parlee, a director of the company and Senior Executive Vice President. On his right is Mr. H. C. Mockridge, also a director of our company and a senior partner of the firm Osler, Hoskin and Hartcourt, and Mr. Crawford also of the firm Osler, Hoskin and Hartcourt; Mr. R. D. Brown of Price, Waterhouse and Mr. E. J. Spence of York University Business School, the company's consulting economists.

We also have present to assist us in such questions as are presented, Mr. I. MacDougall, Deputy Comptroller of the company, and Mr. R. N. Broderick, Assistant Comptroller; Mr. Craig, the company's Tax Manager; Mr. Todd, Executive Vice-President of the company from Toronto; Mr. Pickett, Vice-President in charge of all our operations in the Sudbury district, and Mr. Shane McKay.

Mr. Chairman, I have prepared a written opening statement which, if it is agreeable to the honourable senators, I should like to hand to each of them because the fact is that the words in the written statement are more words than I think you would want to hear in an oral statement. It also opens up the major matters to which we would like to address ourselves. Would it be permissible, sir,...

The Chairman: Mr. Wingate, we would prefer, if you agree, to have you read it.

Mr. Wingate: I would be very happy to quickly summarize it. It is four pages as written.

The Chairman: I think the committee prefers to have an opening summary orally and

we will distribute copies of it because it focuses on the points for discussion.

Mr. Wingate: Thank you. Honourable senators, it is the firm opinion of the executive officers of the International Nickel Company that if the White Paper proposals are implemented the growth of the Canadian mining industry and the contribution by the Canadian mining industry to regional development will inevitably be sharply curtailed.

Now, the reasons are briefly these: first, the profitability of mining operations in Canada and the prospective profits to be achieved from exploration and development will be greatly reduced. It will be very greatly reduced because of major tax increases.

To have a clear understanding of the extent of the increases, I would point out that the combined take which the provinces and the national government would take out of the profits of the mining industry, viewed in terms of the marginal top rate which influences all expansion, in one province would be 58 per cent and in another province would be 59 per cent. My associates will have to remind me which one is Ontario and which one is Manitoba, but that is to be contrasted with the rate of tax applicable generally in Canada to manufacturing companies of 52 per cent, so despite the words in the White Paper to the effect that there should be incentives which are more productive—I think the words are “more efficient”—the end result would be to tax the mining industry, an industry which has made enormous contributions to regional development and growth in the country, and which has a continuing massive job to expand regional development. As a result, the mining industry will be taxed substantially higher than any other industry.

That higher taxation obviously will put out of bounds many prospects that would otherwise have been pursued, and inevitably will force all of us in the mining industry to be cautious—we will not be as bold as we have been before nor as we intended to be in the future, if the tax laws permit us to do so, in pursuing every opportunity where there is a reasonable chance of profit.

But, to suggest again the impact of the increases involved in the White Paper on our own company, had the provisions of the White Paper been in effect throughout the 1960s and had they been fully implemented—we are not dealing with the problem of a transitional program—and had we not altered any of our existing programs nor been

deterred by the heavy potential tax restrictions, and had we done exactly what we did, our taxes would have been 74 per cent higher than they were. Our net income available for massive new projects such as what we did in Thompson, Manitoba, and the \$300 million project we are now engaged in would have dropped by \$30 million a year for each of the ten years in the 1960s.

This is not an imaginary theoretical problem we are dealing with. This is the dent in reduced profit and reduced funds available for exploration and development and for building new communities. The borrowing power of the company correspondingly, obviously, would be affected in a very major way. This is one of the reasons why the growth will certainly be seriously affected adversely.

Another reason is that the consequence of the very high rate of taxation proposed for the mining industry in Canada, at least from the point of view of the burden of taxation, will be that the mining industry will not be competitive with the major important opportunities that exist outside of Canada. I can give you two examples that I think will point that out. If International Nickel integrated operations and were, today, in the United States rather than in Canada, what would be the tax effect? Under the present laws it would be just about a stand-off. It would not make much, if any, difference whether or not we were operating here or in the United States. If the same kind of problems existed, say, in Australia today, we in Canada would have a little edge. But with the White Paper on taxation in effect in Canada we will have a taxation 50 per cent higher than that in the United States.

With the implementation of the White Paper, the tax rate in Canada will be 30 per cent higher than that in Australia. These are detailed calculations that we have made on the assumption that all the things we have been doing in the other two locations were integrated.

The Chairman: Mr. Wingate, when you gave us that figure of the top rate in one province as being 50 per cent and the figure of 59 per cent in another province, were you including federal and provincial taxes?

Mr. Wingate: I included the total take by governments.

The Chairman: That is what is now existing?

Mr. Wingate: No. That is the way it would be under the implementation of the White Paper.

The Chairman: Yes.

Mr. Wingate: At the present time—I will ask Mr. Crawford to bring this out. Am I correct, Mr. Crawford, that the effective rates in Canada for mining, including all of the incentives, are in the order of 40 per cent?

Mr. Crawford: I think it is in the order of 43 per cent.

Mr. Wingate: That top rate would change under the White Paper to 58 per cent to 59 per cent. We have made a study as to what we would have to do immediately in view of these matters I have referred to, lower margins of profit from mining operations here, lower income generated for further capital expansion, lower purchasing power and competitive opportunities elsewhere.

It would be nice to say that we would like to frighten the authors of the White Paper by saying that the \$1,300 million project which we are engaged in is going to be rapidly curtailed and that we are going to stop the major developments that we are currently engaged in with that project. I cannot say so.

True, we started on this massive project before we had any insight into what Carter had in mind. We in principle got ourselves committed to this back early in 1966. After the Carter Report came out none of us really seriously thought that we were going to have a White Paper which, to a very considerable extent, is Carter. We were tremendously surprised. However, we are in so far that we cannot change with respect to that.

We have on the drawing board several important projects which we will launch if substantially the present legislation is retained or modifications are enacted along the lines of what we have proposed to deal with some of the loopholes, and make some of the incentives provide considerably more incentive, thereby becoming more efficient.

We have three mines in the Sudbury district. They are not the greatest potentials in the world. Altogether they may reflect employment of some potentially 800 additional people, directly supporting therefore perhaps 2,000 people. Taking into account the multiplying effect of mining far beyond this, the DCF of those projects we now have under consideration would be so greatly reduced that there is no doubt that if this legislation

is enacted they will be postponed to the indefinite future.

Similarly, we have a major project under way for the study of the entire Moak Setting section of northern Manitoba. This involves extensive exploration with hopes predicated primarily on the development of low grade ores if our hopes are to be materialized.

Under the basis of the present calculations it would not be worthwhile proceeding. The margin of profits would be so unattractive that it would be far better to concentrate that effort in other parts of the world. We would inevitably continue to poke around and do work, but it would not be on anything like the massive scale. We would feel that we simply could not afford to take the tremendous gamble.

There is another aspect in our proposal in which perhaps we have some special expertise and which may not have been emphasized to you to the extent to which I feel we are capable.

That is the effect of the White Paper on allowing or not allowing the opportunity to great Canadian-based mining companies to compete for ore resources around the world.

As we began to realize in the latter part of the 1950's, to some extent we had been living in a fool's paradise for years. We took it for granted that so far as nickel was concerned we had everything here in Canada, all the marbles were ours.

We know now that 80 per cent of deposits of nickel are outside Canada. There can be continued growth inside this country, but there is going to be major growth on the outside.

We have studied important deposits abroad and know that they are competitive with ours in Manitoba. In two areas in which we are most active while we will have difficulties that we do not have in Canada and, of course, we would prefer to be here, the profit opportunities, leaving out the consideration of taxation entirely, are as great and in some cases potentially greater than we now are experiencing and see ahead in northern Manitoba.

Therefore, we and other Canadian-based companies must compete for those deposits and endeavour to maintain our position in the world. We must give our expertise in mining in Canada, which is far superior to that of most other countries, and put it to work in both developed and developing areas abroad.

Under the White Paper proposals Canadian companies are at a horrible competitive disadvantage with other companies in doing this. The reason is that all countries interested in the development of their resources are in one form or another moderating their taxation so as to attract capital.

Some of them have an overall tax structure, let us say limited to 40 per cent. Others may have an overall tax structure more in keeping with the structure here of 52 per cent, then through a variety of incentives they bring that tax down very substantially.

Under the White Paper proposals the incentive granted by the foreign countries to Canadian companies, whether it is granted in the form of an overall lower tax structure or through incentives, is taxed away in Canada.

Senator Isnor: Where are those countries?

Mr. Wingate: The countries in which this applies, sir, are undeveloped countries. Rather, they are countries with which Canada does not have treaties. Canada does not have a treaty for this purpose with the French Government affecting the Province of New Caledonia, which is a major potential source. Nor do we have treaties with any of the undeveloped countries.

The legislation proposes that Canada would not tax away this relief if a treaty was entered into. However, from our experience it is utterly hopeless and fatuous to think that it would be possible to enter into a treaty with an undeveloped country which had not the slightest interest in making any investment in Canada.

They do not believe that if they enter into a treaty Canada will not tax Canadian investors at a discriminatory rate as compared to the manner in which the U.S. taxes American investors.

We are in joint ventures in operations in these areas. Our partners can rightly say to us if you Canadians were out of the picture and this was just an American show there would not be any problems. The United States does not tax away these incentives.

Their structure permits an undeveloped country to grant an incentive that will stick to the fingers of the company that takes the risk of moving in. Under the proposed White Paper legislation any incentive we can get anywhere in the world is taxed away here. The underdeveloped country will say why pay that money? Pay it to us, and the incentive disappears.

That is one very serious aspect of this, because it is absolutely essential with the present potentially profitable resources outside Canada not to lock all Canadian companies into Canada and prohibit them from being a part of this whole mining world.

Senator Desruisseaux: What percentage of this Canadian production is going to export, now?

Mr. Wingate: There would be 95 per cent of the nickel production going to export and 60 per cent of the copper production. I am referring to the entire industry in the case of Sherritt Gordon, Falconbridge and International Nickel. My 60 per cent refers to the entire copper production of the country.

These, sir, are the highlights of this little four page opening statement. If honourable senators would wish to make any comments or address questions to our delegation, we will be pleased to deal with them.

The Chairman: I was wondering, before that, if there are any feature points which some members of your panel wishes to refer to.

Mr. Wingate: Yes, I would very much appreciate having Mr. Crawford present to you concisely what it is that we propose. We know there are loopholes, we know there are incentives that are not as efficient as they should be, and I would think it would be helpful to an understanding by the honourable senators if Mr. Crawford could outline the principal proposals that the company is putting forward.

The Chairman: Mr. Crawford, I take it that, on incentives, you are thinking in terms of the tax holiday and the depletion allowances, and then the treatment of foreign source income.

Mr. Crawford: The principal proposal that perhaps I could refer to is, first—and one which I am sure Mr. Wingate has in mind—is on page 26 of the submission, dealing with the depletion, and the new mine exemptions.

Basically, the proposal is that with respect to new mines, that the present system be modified so that a new mine exemption will only be obtained where the mine is in a remote or undeveloped area.

We think this will have a substantial contribution to regional development, at the same time as it will help the company adjust

in an area where its cost to build roads, railways, infrastructure, etc, will be substantially higher than if the development of the new mine were within an existing developed area. We are suggesting, however, that the three year exemption be limited to the capital invested in the new mine and that therefore if the mine happened to be particularly rich in ore, the exemption only would last a year and a half.

The Chairman: If you stop right there, we have had Mr. McIntyre, who made certain suggestions along that line. And we have had some clarification of what it means. It would mean that the tax exemption continues for three years, but as and when the mine earnings, at any point in that three year period, have equalled the capital expended, then the tax holiday is over. But is it only then, and after that time, that I start writing off any of those expenditures?

In other words, I have a bonus in the tax holiday period, of an amount in earnings equal to my capital expenditure? Is that the position?

Mr. Mockridge: That is our proposal, as indicated in our submission on the Carter Report. It might be feasible to recognize, during the period, that some minimum capital cost will have to be claimed, so that you could not defer all your capital cost to the end of the exempt period.

Mr. Wingate: That suggestion we made in the Carter Report, that there should be an appropriate burden carried.

The Chairman: That brings us to the next question. We have a thought mentioned by some people who appeared to think that in the tax holiday period, the three year period should continue but some percentage of the pre-production expenditures—call them what you like—should be written off, or they should be reduced by some percentage amount, in that period, while the three year period runs.

Mr. Crawford: I think that is consistent with the company's submission on the Carter Report.

The Chairman: I think the percentages that have been suggested have been, it may be, one-third, or 40 per cent—have you any idea—did you suggest a percentage in the Carter Report?

Mr. Brown: That percentage may be high in the case of a mine with a life of five or ten

years, where 5 per cent per year would be more appropriate?

Senator Everett: Did you have any other suggestions to prevent the maximization of profits during the three year period?

Mr. Brown: I think, by limiting the exemption of bona fide new mines, which are clearly in pioneer areas, and where the company is involved in some infrastructure expenditure, and then by limiting the total benefit to the amount of the investment, by further requiring some write-off of capital cost allowances and other allowances during the period, you have effectively reformed the three year exemption and prevented some of the undue incentive that may be available under present legislation.

The Chairman: Under the White Paper proposal, there is no contest as to the need for incentives; and the only question is *quantum*, how much. The White Paper says that what you are getting is too much, and then they make a suggestion which involves eliminating the tax holiday completely.

If we were trying to arrive at a fair ratio between what you spend what you would take in, in that period, you might do it by a lower tax rate. Is that right?

Supposing you had a tax rate in the so-called tax free period, of say 30 per cent, actually you would not pay any taxes, because what you would do is write off your expenses for that amount, but at least they would be written off.

Mr. Crawford: I think our position would be that if you limit the new mine exemption to undeveloped and remote areas, there is justification for the tax free period write-off, as we have suggested.

Mr. Wingate: The period is shortened to whatever date you recover the capital investment. It may be a year and a half, if it happens to be a very profitable operation. Also, as Mr. Crawford pointed out, during that year and a half a proportion of the pre-production expenses and write-off, would be written off.

The Chairman: You have to have that, because the criticism which has been voiced, and which may have given rise to the White Paper proposals is that, with the tax holiday worded the way it is, mines have actually had a tax free period of six or seven years, because they had the three years in which their net and their gross were the same, and

they did not write off anything; and then they started their write-offs in the fourth year; and it took them three or four years to complete the write-offs. So that you have an enlargement of the tax holiday period, and the idea of inserting some necessity for write-offs in that tax-free period, would in theory, I think, remedy that abuse. But I want to get your views on that.

Mr. Wingate: We are in accord with that view.

Senator Everett: Mr. Chairman, if I might ask Mr. Crawford a question. If the total cost of exploration and development were covered in the three-year period, since International Nickel is suggesting a modified earned depletion, would those costs also be eligible expenditures for the modified depletion?

Mr. Crawford: Under our submission, they would be.

Senator Everett: Do you think that is fair? Perhaps I should address that question to Mr. Wingate.

Mr. Wingate: I would address it back to Mr. Brown or Mr. Crawford because they are professionals on this.

Mr. R. D. Brown (Price, Waterhouse), International Nickel Company: I think, sir, the point might well be taken that these expenditures would not also rank for earned depletion once they have ranked for the three-year exemption. This is a technical point.

Senator Everett: It is not so technical when you are getting it three times; you get it once in the fast write-off, once as an eligible expenditure and once on the fast write-off again.

Mr. Brown: Yes, you are quite right, sir, that it reduces the net cost of the expenditure to the company to what might be considered an unduly low point. The basic point of our submission is that what is important in the mining industry is the effective tax rate after considering all of the benefits and incentives involved. We do think the incentives could be more efficient and effective and we do also consider that the effective tax rate that results from all the incentives must be comparable with that in other countries.

Senator Everett: Let us deal with that. Let us deal with the financial statement for the year ending December 31st, 1969. Can you tell me what International Nickel's profits were

after deductions for depreciation, depletion, pension plans, interest on long-term debt, but before taxes on income?

Mr. Brown: I do not have the financial statement in front of me, sir.

Senator Everett: Perhaps one of the controllers could help us in that regard, Mr. Wingate.

Mr. Wingate: Perhaps Mr. Broderick can help us on this.

Mr. R. N. Broderick, International Nickel Company: That would be \$174 million for the year 1969, using the annual report.

Senator Everett: So the net, with all those items deducted, but before income tax, would be \$174 million. Can you tell me what taxes International Nickel paid on that profit?

Mr. Brown: Taxes based on income, sir, amounted to \$58 million, in addition to other substantial taxes on goods and services, and they are of course included.

Mr. Wingate: I believe the total is approximately \$80 million paid in taxes of all kinds.

The Chairman: Does that include the mining taxes?

Mr. Brown: Provincial mining taxes in Ontario and Manitoba.

Senator Everett: Your point is well taken, sir, but to come back to the point we were discussing. On \$174 million profit, there is \$58 million paid in taxes. How much of that \$58 million was deferred?

The Chairman: You mean for corporate purposes? There are two statements, one goes to the income tax people and is not published, where I assume they make their full claim, and then in the corporate statement I take it you defer some of the taxes.

Mr. Wingate: You are referring to the future tax component in that?

The Chairman: Yes.

Senator Everett: Mr. Brown has been talking to us about the incidence of tax on International Nickel, and I am trying to determine what it is today.

The Chairman: Senator Everett, Mr. Broderick has an answer.

Mr. Broderick: In answer to that question, it is about \$27 million.

The Chairman: That is for corporate purposes?

Senator Everett: \$27 million.

Mr. Broderick: Out of \$57 million.

Senator Everett: \$27 million was deferred. So therefore would not the correct figure be \$34.1 million for deferred taxes?

Mr. Brown: The \$27 million figure, sir, relates to the long-term deferral, but the \$34 million includes \$6 million included in current income, but your total figure is correct.

Senator Everett: Coming back to the question; what actual taxes did International Nickel pay on its income? I suppose we are talking there of federal income tax.

Mr. Brown: Mr. Macdougall could get that figure. I believe it should be pointed out that 1969 was a very unusual year as far as the company is concerned because of the strike.

Senator Everett: Your point is well taken. But we could go back to 1968, and I am prepared to do that. But is it not the calculation that out of \$174 million, International Nickel paid \$23 million in taxes in 1969?

Mr. Brown: I think the correct figure for any burden of taxes on any company in Canada would include deferred income taxes. These are taxes which are deferred from one accounting period to another because of the accelerated allowances. Therefore they must be included in the amount of taxes actually paid to the Government. This is what any other Canadian company would do in the circumstances.

Senator Everett: I don't want to create the wrong impression.

Mr. Wingate: Will you give us the 1968 figure please?

Mr. Broderick: For the 1968 figure, we paid a total of \$46 million, of which \$30 million was for federal income taxes. The balance went to the provinces. That means about \$16 million went to the provinces.

Senator Cook: But your total income tax liability for 1968 was \$86 million.

Mr. Broderick: I am talking now of actual payments.

Senator Everett: Then taking the 1968 figures, the net income was \$231 million, of which \$87 million in taxes were exigible. I do

not have the figures as to how much of that was deferred and how much was payable in that year.

Mr. Brown: About \$40 million was deferred and the balance was payable in 1968.

Senator Everett: What we are trying to assess is—and you make a very good point in your brief regarding the imposition of taxes under the White Paper proposals on the mining companies—but one of the items we are trying to assess is the effect of the fast write-off. Is this a fair exchange? We do not know, but we are trying to determine whether or not this is a fair exchange for some of the suggestions that have been made in the White Paper. We try to look at the effect of the deferral of taxes. Admittedly you have to pay them, but you keep on deferring them so that at the present time International Nickel's deferrals at this point amount to \$160 million.

Mr. Brown: That figure, incidentally, is not a blind figure of deferred taxes which appear on the balance sheet of many other Canadian companies. With respect to the accelerated allowances provided in the White Paper, these would in part compensate for the other proposals in the White Paper but only to a very slight extent. What the accelerated allowances do is to provide cash. In effect, they increase the company's cash flow but do not decrease in the long run the total income tax burden on the company, and over a period of years, of course, their effect is done away with unless the company continues a very rapid expansion program. The impact of these accelerated allowances, therefore, does not provide cash in a very long-term sense to the company for expansion and growth.

Senator Everett: Looking at the situation here, it appears that the company has been paying somewhere in the region of 25 to 30 per cent of its net income in taxes—that is federal taxes—or that amount has been exigible but a portion of that amount has been deferred tax.

Mr. Brown: Yes, if you look at the figure for the Canadian company alone. The balance sheet you are looking at includes the United States and other operations.

Mr. Wingate: And these figures do not include the income tax we are paying in Great Britain and the United States. What we are talking about here is the income tax paid in Canada related to our combined earnings everywhere.

Mr. Brown: The effective rate in Canada has been well over 35 per cent.

Mr. Wingate: Will you give the conclusion that you just gave.

Mr. Brown: The effective rate in Canada for International Nickel in the past has frequently averaged well in excess of 35 per cent. It varies from year to year primarily with the impact of earnings from exempt mines. In the early 1960s, for example, it was relatively low because of the earnings in the Thompson project in Manitoba.

Senator Benidickson: In your proposals you appear to be very frank and fair with the committee in that you do not say that only the present system is acceptable. You suggest very substantially in your recommendations that you can spare greater taxes in that you would forego the tax holiday of three years under certain circumstances. That is, where you go into an area where there are existing mines.

Mr. Wingate: Well, senator, I would not want to leave any feeling that International Nickel has indicated that it believes it can stand higher taxation or that it should take a larger cut. The combined effect of our proposals, namely, 20 per cent depletion allowance—a reduction from 33 to 20—and the substantial modification of the new mines exemption, in accordance with our best guesses looking forward, would probably increase our tax burden, compared with the present foreseeable tax burden, by approximately 10 per cent. That is what we think the combined effect would be.

Further, if we should be so fortunate as to discover numerous mines in numerous different areas to be developed, it is conceivable under our proposals that the reduction would not be as much as that. But using the best foresight we can on the situation, we may, under our proposals, get a tax burden on the company over the next ten years in the order of approximately 10 per cent more than the tax burden under the present legislation.

I think Mr. Crawford did not quite complete the assignment that I proposed. He did address himself to new mines exemption, but I do not believe that he addressed himself to the other aspect, that is, the reduction of the percentage depletion and what the combined effect of this would be.

The Chairman: No, I noted that.

Mr. Crawford: I was only dealing with the tax holiday feature because...

Senator Benidickson: You are proposing something rather different than we have heard generally from the mining industry which objects per se that this existing incentive be eliminated.

The Chairman: On that point I was wondering whether the 10 per cent increase you have projected—in arriving at that you have reflected the adverse effect of foreign-source income.

Mr. Wingate: We have not taken into account foreign-source income in that calculation nor have we taken into account the fact that, if the White Paper were implemented, it would be very, very different. In that situation many of the things we are now planning and hoping to do in the future may not be done and, therefore, our taxes may be a lot less because our income may be a lot less.

The Chairman: I am trying to figure out the basis on which you made the calculation which, as a result, your taxes may increase by 10 per cent. I want to know what factors you used to make that projection.

Mr. Wingate: Well, we assumed that we would have a 20 per cent rather than a 30 per cent depletion allowance and we made the calculation on the basis of the opportunities we foresaw to go into some new mine development operations in areas that we are not in now, and in applying the recommendations we propose and asking ourselves whether these recommendations result in International Nickel paying more taxes, it is our judgment that it would result in our paying more taxes. There would be an increase in the order of 10 per cent.

I would like Mr. Crawford to point up the rationale involved in suggesting 20 per cent depletion as distinct from 33 per cent, and the competitive position we believe we would find ourselves in relative to opportunities outside of Canada.

The Chairman: I just want to be clear on this. Really your 10 per cent was based on an application of the formulas that you propose.

Mr. Wingate: That is right.

The Chairman: In relation to the tax-free holiday and depletion.

Mr. Wingate: Correct.

The Chairman: And that you propose that your best projection is a 10 per cent increase.

Mr. Wingate: That is right.

The Chairman: Well, that is not related to the White Paper proposals.

Mr. Wingate: No, it is not related to the significance of the White Paper.

Mr. Crawford: The other aspect of our proposals is two-fold with respect to depletion. First of all, I suggest that the percentage continue at a reduced rate of 20 per cent but be calculated on the net profits after the deduction of exploration and development expenditures. That is, to remove the disincentive benefit under the present calculation where, with more exploration and development expenditures, you have less depletion you can claim—

The Chairman: Is that not another way of calculating the gross production income?

Mr. Crawford: Net on expenses.

Senator Everett: How does it vary from gross production income?

Mr. Walker: Gross production usually means the sales of products at the pit's mouth, the value of the product. The product we are talking about here is the value of the production less all of the operating expenses necessary to maintain that.

The Chairman: In the United States it is simply based on the sales price and the cost is not taken into account.

Senator Everett: Yes.

The Chairman: We are talking of net value.

Senator Everett: You are somewhere in between. Can you tell me how much this 20 per cent is worth in relation to the 33½ per cent, which is of your net? In other words, is it 33½ per cent of—

Mr. Brown: No, sir. In Inco's case it worked out to something like 23 or 24 per cent.

Senator Everett: Twenty-three or 24 per cent would be the effective net.

Mr. Brown: It would vary a great deal with expenditures.

Senator Everett: We understand that you are proposing 23 or 24 per cent as opposed to 33 per cent.

Mr. Brown: Yes.

Mr. Crawford: To develop this, if you take your top rate of tax under the White Paper proposals, including your taxes of 57 or 58 per cent, our calculations indicate that the 20 per cent depletion allowance would reduce our tax rate to approximately 48 or 50 per cent.

Now, we start on the basis of a rate that is slightly under the manufacturers' rate but which gives us a push towards the competitive rates in other jurisdictions. Then we say, if we are going to be competitive with other jurisdictions, we have to earn and we would earn on unearned depletion, that is, on a \$1 for \$3 basis, the same as the White Paper proposes but on a much broader basis.

Under our calculations today we could obtain in the aggregate the same depletion as we would have today. We would have to spend for earned depletion expenditures that qualify for earned depletion, about 20 per cent.

Mr. Wingate: I think it is fair to speak in terms of the percentage of our earnings and cash flow. We would have to spend 30 per cent of our earnings.

Mr. Crawford: Thirty per cent of our earnings, or in excess of 20 per cent of the total cash flow, to bring ourselves down to where the incentive would be as great as it is today. Our calculations, even with very substantial exploration, development and growth expenditures, would not bring us down, as Mr. Wingate has indicated. However, if we spend a very substantial amount of money we reach the point where we feel we are competitive with the other jurisdictions to which Mr. Wingate referred.

The Chairman: By making use of earned depletion on the basis that you suggest and which is contained in the White Paper, by how much would you reduce that 48 per cent to 50 per cent?

Mr. Crawford: We could bring the rate down by this very high level of expenditure to which I have referred to approximately 37 per cent to 38 per cent. However, it would have to be the maximum level of expenditure to which I have referred.

The Chairman: And that would certainly maintain your competitive position.

Mr. Crawford: Yes. I should contrast this, which appears on page 2.3 of our submission.

During the 1960's, with the White Paper implemented and assuming, which of course is a questionable assumption, that all of the things that the company did would have gone forward, the company spent on an average over those ten years \$21 million that would have qualified for the White Paper's concept of earned depletion. That is \$21 million per year.

The overall effect of this would have been to reduce our tax rate by some 3 percentage points.

In addition, as we point out on page 2.3, we committed an average of \$60 million extra to risk capital over and above the \$21 million that would not have qualified for the White Paper's earned depletion.

Senator Phillips (Rigaud): Has anyone dealt with the subject matter as to who would determine what is a pioneer mining area?

Mr. Wingate: Mr. Spence, perhaps you could direct yourself to the problem of regional development and an appropriate criterion for the selection of a qualified area.

Senator Phillips (Rigaud): Before the answer, might I make the following observation: yesterday for the first time we were considering the idea of depletion allowances coming under two headings. One, the continuance of the existing rates to mines now in operation. Two, a revised depletion arrangement applicable to the opening up of new mines.

Is it feasible, once we determine what is a pioneer mining area, to deal with the subject matter of depletion as well as the subject matter of the three year tax exemption by way of differentiation between existing and new operations?

A number of mining companies have taken the position that were there a reduction in the depletion allowances presently granted they would find themselves in a seriously difficult financial position. There would also be a breach of faith with underwriters and investors who purchased their securities based upon the then existing depletion allowances and tax holiday.

The Chairman: Would you like the pioneer question answered first?

Senator Phillips (Rigaud): Yes, the pioneer question first and we will then relate it not only to tax holiday but to depletion.

Mr. E. J. Spence (York University Business School), International Nickel Company: Mr. Senator, as far as the pioneer concept is concerned, we have been aware of the preoccupation on the part of those advising Government with the need in this country to employ our resources more effectively. We are not as productive as other countries.

One of the preoccupations in this more effective employment of our resources is to use them more effectively in presently underdeveloped areas. The other is, of course, the area that is not developed at all and where if those resources exist and can be found a greater improvement in our productivity can occur.

This philosophy is reflected in a number of aspects of Government policy, such as the various steps that have been taken to stimulate regional growth and provide special incentives in the less developed areas.

We suggest that mining is the most obvious and in many respects the only way in which many of these areas can expect to be developed. If this is the case, then mining, which after all must consider rates of return, must be placed in a position where its assessment of the risks and probabilities in those areas is matched by its expectation of rate of return.

This is the reason we suggest that the new mining exemption will be efficient and effective if applied to that sort of judgment of the presently underdeveloped area where the costs and risks are greater than may well be the case in other areas.

The Chairman: Would you attempt to define your concept of a pioneer area?

Mr. Spence: We feel that in broad conceptual terms we could present the idea. However, it is beyond our capability to define these areas exactly.

The Chairman: Well, the White Paper attempts to do so.

Mr. Spence: Our consideration was, of course, largely the non-existence at the moment of either infrastructure or any of the facilities for supporting communities in that area as it now exists.

The Chairman: The language of the White Paper where it praises the efforts of the mining companies before cutting the incentives says:

Secondly, it is recognized that the exploration for and development of min-

eral deposits continue to provide special benefits to Canada and to various provinces by creating or maintaining highly productive industry in areas other than those where rapid urban and industrial growth are already occurring as a result of both private and public efforts.

Would that in general be the concept?

Mr. Spence: Yes, that of course, does not define boundary lines, which was the point to which I was addressing myself.

It is the determination of what is in fact such an area and how the boundaries should be drawn around it which we believe to be beyond our scope to define precisely.

The Chairman: It may be difficult to make a specific definition, but maybe the word in itself has such a connotation that you would be able to draw boundaries if you had a particular case you were dealing with.

Mr. Wingate: We would think so.

Senator Benidickson: Mr. Wingate referred to the fact that Inco at the moment, apart from the new tax rates, was looking at what would be regarded as three new mines in the Sudbury area, and then the development of a mine which he described as "the remote area" in northern Manitoba—under the recommendations proposed here with respect to tax holidays, they would be the three mines that you are looking at for development in the Sudbury area, they would be regarded as unentitled to new mine status in the tax holiday, and the one in Manitoba would evolve in the infrastructure and would be regarded as a new mine and entitled to a tax holiday.

Mr. Wingate: I might ask Mr. Parlee to comment on that?

The Chairman: Let us clarify what you are asking. It is whether the three mines that were mentioned, to be developed in the Sudbury area, would qualify as pioneer.

Mr. J. C. Parlee, Senior Executive Vice-President, International Nickel Company: The three new mines that we were discussing—which are Cryderman, Blezard and Whistle—are adjacent to already developed communities and, in our opinion, would not necessarily be considered as new mines. However, the one we are developing now at Shebandowan would, in our opinion very definitely be a new mine.

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The Chairman: Then you would expect those new mines, not in the pioneer area, not to receive any of what I call unearned depletion?

Mr. Parlee: Oh, yes, they would earn the unearned depletion but would not earn the tax exemption.

The Chairman: They would not earn the tax holiday.

Mr. Wingate: They would benefit from the 20 per cent percentage depletion which, as Mr. Crawford pointed out, would mean that, taking into account provincial taxation, those mines would be subject to taxation of somewhere between 48 and 50 per cent. They would not rank as new mines. There would be opportunity for earned depletion, based on the extent of the expenditures applicable to those mines. Those expenditures, by definition, would have to be made, because of the non-existent operation. And the impact of that earned benefit to the company, I think, as Mr. Crawford pointed out, would bring the effective tax down to something of the order of 38 per cent.

The Chairman: That is right.

Mr. Wingate: Squarely in keeping with the general competitive position externally.

Senator Phillips (Rigaud): If the logic applies with respect to tax holidays, to pioneer mining areas, why should not that logic be extended in dealing with the subject matter of depletion.

Mr. Brown: I recognize that the point is outstanding, sir.

Senator Phillips (Rigaud): Under depletion, you provide for a formula. There you do not provide any distinction between opening up of pioneer mining areas. You cover the whole show. But with respect to tax holiday you only deal with pioneer mining areas. What I want to know is, following the logic, which I think is sound, opening up Canada, and so on, why do we not apply the further incentive in respect to depletion, to the opening up of pioneer mining areas?

Mr. Brown: I think our feeling, sir, was that most of the special problems and risks of the pioneer areas, and the desirability of the stimulating exploration and development in those areas, was satisfied by our approach to the tax free period.

When we consider percentage depletion, we regard this as necessary to provide an incentive to mining development, having in mind its risks and its problems, irrespective of where that mine may be located. So, in effect, you take care of the rather special circumstances in the one, and then the percentage depletion applies to the general problem of providing a sufficiently high rate of return, in prospect on a mine, to compensate for the risks and costs involved generally and the competitive situation when alternatives outside of the country are being considered.

Senator Phillips (Rigaud): Can I get an answer to my last question, and I will not bother you any more. There was a suggestion in some quarters that the present rates be applicable to mines now in operation and the modified depletion allowance be after the opening up of the mine.

Mr. Brown: Mr. Wingate, would you like to deal with that or would you like me to do so?

Mr. Wingate: I would prefer you to deal with that.

Mr. Brown: In all of our proposals we have attempted to give acceptable and realistic alternatives to the proposals in the White Paper, which we believe would have the disastrous consequences which we have described and which Mr. Wingate has described.

We believe that what we have proposed would be satisfactory. It does indeed carry conceivably an element of bad faith, in that past commitments were made in the expectation that even higher rates of return would be available and if it were considered administratively practical, I think we would find the perpetuation of that rate very acceptable. But we have not asked for it, in all the circumstances.

Senator Phillips (Rigaud): Do you not think that you have a sound case for saying to Government that major financing was consummated on the basis of certain things and surely that should be applicable in respect of certain operations? I do not know. I am just putting the point.

Mr. Brown: I am personally very sympathetic to that view, sir. I think we have been attempting to deal, perhaps, with the art of the practical and the possible.

The Chairman: Mr. Parlee, on that point, International Nickel at the present moment, I

would take it, in its main operations, has run out of the tax holiday period and therefore the only incentive that it enjoys under the present law is the depletion allowance of 33½ per cent?

Mr. Bown: That is substantially correct.

The Chairman: What you propose really, the combination of the two things you propose, would perpetuate the 33½ per cent, would it not? If you spend up to the limit of \$3 and get \$1 bonus and you get 20 per cent on your production income, net.

Mr. Brown: Yes, I think the point, senator, is that the 20 per cent depletion allowance, the so-called unearned depletion, is really necessary to compensate for provincial mining taxes and to reduce the rate of tax on an existing mine to roughly the same marginal rate that would apply to a manufacturing company; and the further incentives that we propose are based only activities in pioneering mining areas or on expenditures on new development and exploration.

Senator Everett: Mr. Chairman, I think the suggestion that International Nickel has made in reference to new mines in designated areas is an excellent one, and especially the overtones of regional development; so I have no quarrel with that at all.

I would like to move away to the other parts of your proposals. What in your proposals would induce International Nickel to develop marginal properties, next to properties that they already have developed?

Mr. Wingate: We would be induced to do that by the profit opportunity which is present in the approximate 33 per cent depletion. But we have suggested that we achieve that objective through a 20 per cent depletion which more or less matches the burden of provincial taxation, and that we be forced to spend something like 30 per cent of all or our net earnings in equipping these new mines involving the development of whatever quality of ores are present, and we feel that given a total depletion, which we think for us will work out somewhere between 30 and 33 per cent, there are important marginal things that we see that will, with that relief, provide a sufficient profit for us to take a gamble on developing.

We are quite satisfied that if we were simply to be knocked down 20 per cent and did not have some kind of mechanism to earn the difference, that we could not and, having

regard to the reduced profitability and having regard to the fact that over the years we would have generated a build-up of cash to get into things of this kind, we would not be able to do it. We think it would place out of bounds important potentials that we see ahead, and the biggest ones we see are in this low percentage area where there will be continued very expensive exploration but where we will be able to turn up low-grade deposits which given the relief of the order of 30 to 33 per cent, and therefore an overall tax burden of around 38 per cent, we can make a go of it.

Senator Everett: I agree, and you are interested, naturally, in the overall relief. But what we are trying to determine is, while not disagreeing with you on the question of overall relief, how can it be packaged to do the things that are in the best interests of the country at large.

The Chairman: And the whole basic mining industry.

Senator Everett: The whole industry, yes. I gather your suggestion for earned depletion is an essential part of an inducement to cause a mining company to develop marginal properties, is that correct?

Mr. Wingate: Yes, and I would like to ask Mr. Parlee to comment on that.

Senator Everett: Before Mr. Parlee comments, I would like to ask another question on that point. As I understand it, the White Paper proposals do not permit as eligible expenditures those items spent on existing mines.

Mr. Brown: That is correct.

Senator Everett: Then I would think it is a very essential part of your suggestion on earned depletion that those expenditures be eligible for the purpose of developing these marginal properties.

Mr. Parlee: That is correct. And we think we should go far beyond that and get relief through the refineries, the smelters and anything else that encourages further treatment of these ores in Canada. We feel that all of them should earn depletion. The opening up of marginal properties, low-grade properties, close to developed areas, is encouraged by itself in that you have the basic infrastructure and you have the basic plant, so you are just expanding the plant rather than building a new one, and that is cheaper to do.

Senator Everett: Are you saying that you would do it anyway or without the incentives?

Mr. Parlee: No, no, but I am saying that we consider there is sufficient incentive in what we have suggested here.

Senator Everett: But I want to underscore the point that while the overall rate of 33½ per cent is essential to this sort of development, your concept of earned depletion with the lighter definition of eligible expenditures would make that—the opening up of marginal properties—more likely, is that a correct statement?

Mr. Brown: Yes.

Mr. H. P. Crawford, (Osler, Huskin & Hartcourt) International Nickel Company: Senator Everett, just for the record, we have in Appendix E to our brief an argument in which we elaborate on why we think the base should be broadened.

Senator Everett: Do you suggest in that appendix that town site construction should be included as part of eligible expenditures?

Mr. Parlee: Yes.

The Chairman: And railroads, if necessary?

Mr. Parlee: Yes.

The Chairman: That is in line with the Ontario proposals.

Senator MacNaughton: Mr. Chairman, I don't know if this is the appropriate time, but I have an idea which might be useful for us if not for the company. Mr. Wingate in his opening statement was very persuasive and, I thought, very interesting. Would I be correct in summarizing it as follows; you are saying that you feel that if the White Paper proposals are brought into force and effect, it could result in slow strangulation for your company?

Mr. Wingate: I think our written presentation says that it is our belief that the industry would be static. It is my belief that in the long run the industry would have to shrink, that we would not be able to replenish or build reserves which are profitable or sufficiently profitable to justify the large continuing capital expenditures required, and that with this heavy incidence of taxation, the opportunities ahead would shrivel and gradually the entire industry would become smaller.

Senator MacNaughton: Especially in view of the developing world competition?

Mr. Wingate: That will contribute to it. It will attract capital which is necessary to be attracted from abroad, and it will attract capital that is here to move into those other areas.

Senator MacNaughton: Could I perhaps refer to the Chairman's message to shareholders, and could I take your own words? The purpose is, I suppose, to prove your won case or certainly not to destroy it. The order in which I would take your words might not be the same, but at the end, if I could have permission to read them into the record, I think you will agree that they are important. At the end you can agree or disagree. In your Annual Report which is dated February 19, 1970, on page 3, you say:

Our current program to expand our Canadian production started in 1966. It has now reached the period of peak construction activity. By the end of 1972, we estimate, we shall have invested \$1,100,000,000 in this program,...

Then later on you say:

Beyond it lies our participation in projects outside of Canada. No precise timetable nor forecast is possible, but investments by us and by our associates in them could be in excess of \$500,000,000 over the next half decade.

Then you move to page 2 and I move to page 2 where you say:

Many factors affect the costs involved in developing an ore body; the tax burden is a most important one.

Then I assume you state your conclusion:

It is not in Canada's self-interest to stunt the growth of its mining industry or penalize Canadian companies as they seek producing properties outside the country in competition with companies based in other countries.

I would imagine that must be your position. Is that a correct statement of it?

Mr. Wingate: That is, sir, but I think somewhere in the statement I made it clear, because it is the fact, that we are hopeful not only to have expansion beyond our \$1.1 billion project; we are hopeful that we can continue to expand in Canada as well as in moving to areas outside of Canada. Inevitably there will have to be a somewhat greater

emphasis on the non-Canadian because of the recognition now of two things, one, the presence of vast quantities of ore, and second, that substantial portions of those deposits are, under existing legislation, competitive with the Canadian deposits, and some of them are in fact more attractive. But I would not want the particular words I used there to carry with them any suggestion that we are thinking of the \$1.1 billion as the end-all as far as Canada is concerned. It is not so.

The Chairman: Mr. Brown, I have one question I wanted to get at when I was talking to you about tax holiday and depletion and the relationship of them. You gave us your formula in connection with the application of the tax holiday, and my question is: when would the depletion start, at the end of a tax holiday period?

Mr. Brown: Yes, sir. The depletion would start then.

The Chairman: You were asked a question as to how many things you would have working for you at the same time during the tax holiday period. You would have your expense deductions as part of your costs, I suppose, if you wanted to take them. You would have your depletion allowance after your tax-free holiday.

Senator Everett: They have suggested, Mr. Chairman, that the eligible expenditures for which they receive a deduction during the three-year exemption would not be available as eligible expenditures for depletion.

Mr. Brown: Yes, I think that would be a reasonable assumption, sir.

The Chairman: Would you say that again?

Mr. Brown: In the course of developing a new mine the three-year tax exemption on its earnings will not rank to earn depletion after that three-year exemption period is over.

Senator Everett: To the extent that it was recovered. If it was not recovered, that portion would be available.

Mr. Brown: Right. If I could correct a statement that was made earlier on the record, senator, you raised the question: what is the equivalent percentage under the present depletion laws to the 20 per cent depletion suggested by Inco on the basis of production profits after exploration and development. I mentioned a figure of 23 or 24 per cent under the existing laws as being equivalent to 20 per cent.

I now find that in Inco's case it would actually be closer to 22 or 23 per cent. About 22 per cent under the present laws would be the equivalent of the 20 per cent suggested in the brief.

Senator Everett: Thank you very much. That is very interesting. I think you said that the rate under your proposals would be somewhere around 37 per cent.

The Chairman: I think you said 37 or 38 per cent.

Senator Everett: Is that affected in any way by your suggestion that the amount of depletion that is not deductible in any one year be carried forward to a point where it is deductible?

Mr. Brown: Not in the case of this company, no, sir. The depletion would be currently used and, therefore, it would not have any effect on our particular tax position.

Senator Everett: Do you still propose the faster write-offs?

Mr. Brown: Yes, sir.

Senator Everett: Would this have any effect on the over-all tax rate of 37 or 38 per cent?

Mr. Brown: Not the way we calculated it which is on a very long-term basis, that is, on the life of a mine or the life of a project. It has implications on the time in which you pay tax, not on the total amount of tax you pay and, therefore, not on the average tax rate over the life of the mine.

Senator Everett: So a portion of the taxes could be deferred. This is nothing more than a deferral.

Mr. Brown: Yes, that is right.

Senator Everett: You concede that is not a deferral to infinity.

Mr. Brown: Deferred taxes in Inco's case and in any other company's case tend to build up over time as long as the company is going through a massive expansion program, but there are definite limits on the build-up. In Inco's case and in the case of other companies I do not think, really, a continuation of the build-up for an indefinite period is being very realistic. I do not think that is what is going to happen.

Senator Everett: I think it is most important that we understand your position. It

is a deferral, and in your judgment there comes a reasonable length of time when it is actually paid.

Mr. Brown: I think the correct way to look at it is: on any single project the taxes that are deferred during the opening years are recovered by the Government from the project in later years. If you wish to have a further deferral, you have to go out and find a new project and spend some more money.

Senator Everett: I just wanted to get it straight in my own mind. The Government and the White Paper seem to put a great deal of emphasis on the fact that this faster write-off is available. In your judgment that is not really, I gather, that much of an advantage.

Mr. Wingate: Senator, we made a calculation to this effect. Suppose we were developing our new Coleman mine which is located near Levack, and suppose a similar mine in Minnesota had precisely the same intra-structure but lacked the same opportunities that exist at Coleman, where would we stand?

In any such calculation, of course, you have to take into account the faster write-offs available in Canada and the somewhat less faster write-offs available in the United States.

We found in making this study where we would stand under the White Paper, taking into account the benefit that the faster write-offs would give us, that Minnesota would be substantially more attractive than a mining operation in Canada.

I do not recall the exact figure, but in Canada on that operation, with the implementation of the White Paper, we would have a discounted cash flow of something in the order of 13 per cent. In the United States we would have a discounted cash flow under their existing legislation of approximately 13 per cent.

Senator Everett: Stop right there, Mr. Wingate. That was the explanation I was looking for.

Mr. Wingate: Now, under the White Paper, the discounted cash flow would be in the order of 10 or 11 per cent.

Senator Everett: I am sorry. The 13 per cent applies to Minnesota?

Mr. Wingate: The 13 per cent applies to Minnesota and the 10 per cent applies to

Canada. It may be closer to 11 per cent; it is between 10 and 11 per cent. Now, the difference between 13 per cent and 11 per cent DCF is a very, very big difference, as any financial man would advise me and as you would recognize.

Giving ourselves the full benefit of the write-offs here, the operation here would be substantially less attractive than an identical operation under the existing United States laws.

Now, you say, how would it work under Inco's proposals. Under Inco's proposals in that particular example we would be slightly better off in Canada than we would be in the United States, but it would be practically a dead heat.

Senator Everett: Thank you very much.

The Chairman: Now, Mr. Wingate, no person—and I have complained to several people who have appeared before us—seems to have put forward the position of the shareholders of a mining company and the depletion allowances that they presently enjoy but which will be done away with. Have you any comment to make on that?

Mr. Wingate: Mr. Mockridge or Mr. Crawford may comment on that.

Mr. Crawford: This is referred to, Mr. Chairman, on page 5-3 of our submission.

The Chairman: It has not been mentioned. This is what I was referring to.

Senator Benidickson: You refer to tax credits but you do not refer, do you, to the existing depletion allowance for shareholders?

Mr. Brown: At page 5-3.

Senator Benidickson: Yes.

Mr. Brown: We suggest that to take this away may be unfair to Canadian shareholders who have taken the allowance into consideration in their decision to acquire the shares. Also, it tends to make the shares of Canadian resource companies less attractive to Canadians and more attractive to non-residents.

The Chairman: Mr. Crawford, to the extent that a shareholder does not get the depletion, he is paying more taxes.

Mr. Crawford: Exactly.

The Chairman: Therefore he is supplementing what the Government says it is giving away in incentives to the company.

Mr. Crawford: That is right. This point does not go as sharply as it does in the lack of any flow-through to the shareholders, under the White Paper, of tax that is not paid by the company with respect to its depletion.

We feel, as we point out in our submission, that this is an area of tremendous concern in terms of Canadian mining companies that would like to continue to have substantial ownership of their shares by Canadians.

The Chairman: There are two sources for your risk capital; one is that you borrow money and the other is that you get people to invest in shares. Well, surely incentives should be attractive to both kinds of contributors of capital, and yet the White Paper acknowledges that incentives are needed, but they are only one-sided in the way they give them.

Senator Molson: Well, I do not see why it would be more attractive to non-residents.

Mr. Crawford: The argument, Senator Molson, is that if you remove from the mining companies the shareholders' depletion, their investment in Canadian mining companies will be relatively less attractive as opposed to an investment in a non-mining company that is in Canada.

Senator Beaubien: A non-growth company.

Mr. Brown: A non-growth company, and it should follow that their mining stock will go down somewhat in value. And if it goes down in value, it should make it a bit more attractive relatively to the non-resident.

Senator Benidickson: You indicated in the annual statement which was circulated to us this morning that in 1969 your net earnings per common share were \$1.56. Of that \$1.56 what did you distribute to shareholders as dividends?

Mr. Wingate: Our distribution for the past ten years has averaged 61 per cent of our earnings.

Of course, last year with the very difficult strike that we went through and the maintenance of the same level substantially of dividend payments, the distribution was a very much higher percentage. However, considering 1960 to 1968 I think I am correct in saying that the average distribution in that period was 61 per cent of our total earnings.

That, I think, is reasonably in keeping with what other large Canadian mining companies have been distributing out of their earnings.

Senator Everett: Mr. Wingate, could I ask you how much creditable tax under the White Paper International Nickel would have produced in percentage terms in the last two or three years? You say you pay 60 per cent out in dividends. What percentage of that would be creditable tax?

Mr. Wingate: I am very glad you raised that question, because the results for our shareholders would be very erratic. In determining what goes through we take into account income that comes in from foreign subsidiaries. That which is coming in now under the present and proposed legislation would all flow into the parent company tax-free. Therefore the Canadian investor in a company as active internationally as we would receive a smaller pass through.

In addition to that, of course, there are the incentives of the earlier write-off, all of which operate in determining what the pass through shall be.

In 1965, using the White Paper 40 per cent would be the ratio of creditable taxation to net earnings and the shareholder would expect relief accordingly. However, having gone through this strike situation where the local income subject to tax was considerably reduced, the creditable was 9.74 per cent. In the year before, 1968, it was 20 per cent. Two years before that, in 1966, it was 32 per cent.

Just think of the problems that are presented to financial advisers when advising Canadians as to whether they should hold international stock because of the amount of pass through that they are not going to receive. The shareholder will come in and see three years in a row of approximately 45 per cent of creditable tax. In 1967 he finds he is receiving only 25 per cent and in 1969 only 9 per cent.

If he is bright enough to anticipate these tricky consequences, he will have to unload quickly and get back in at a time when there is a substantial creditable tax.

We think this can be a very harmful factor in the conscious effort we have made, as indicated by the two past splits of shares, to try to build up a large body of Canadian ownership. Canadian ownership of a company with international income which is not subject to tax is discouraged in favour of investing in

a wholly local company with a large creditable tax.

At the present time we have been fortunate. We have some 50,000 Canadian persons holding our stock out of a total of approximately 84,000. We have more than 50 per cent of the individuals owning our stock and the number of individuals has gone up most sharply since our last share split.

The percentage of our stock held in Canada has grown very substantially from 25 per cent or 26 per cent to 31 per cent.

We are certain that the present incentives to shareholders in Canada of investing in a mining company where a portion of the income will not attract taxes because of incentives, particularly in an international mining company which has income from abroad which would be free of tax, will be greatly reduced relative to investing in a company where there is a large pass through.

Senator Everett: You have two problems, do you not: one is the ups and downs of the size of the creditable tax...

Mr. Wingate: Yes, two distinct problems. The ups and downs are very frightening. It is difficult even for those of us close to the company to predict how it is going to work out.

Senator Everett: But over and above that, if the average were 30 per cent, then I gather that if the White Paper were in operation half that dividend paid by International Nickel would be fully taxable without deductions?

Mr. Brown: Yes.

The Chairman: Are there any other features, Mr. Wingate, on which we should hear you? You can assume that by this time we are pretty well briefed on some of these items, but we would like to hear any special features.

Mr. Wingate: I would like to mention two points. We have discussed the amount of tax International Nickel has been providing to Canada. The figure in 1968 was of the order of \$60 million. Looking to 1970, without getting myself into difficulties with the SEC, I think the figure is going to be of the order of \$100 million. That is the order of contribution that our company will be making to the tax collector under the present legislation. That is in consequence of the expansion that is taking place with increased production and the profits attributable to that production.

The Chairman: Regional development.

Mr. Wingate: The total amount we see for 1970 and 1971 is of the order of possibly more than \$100 million, compared to \$60 million in 1968. I think honourable senators would be interested in remembering that while International Nickel is an international company it is the fact that today all its basic production is here. 95 per cent of that basic production is carried through to final marketable form inside Canada. Canadians have a huge stake in this.

The Canadian investment in International Nickel is greater than the Canadian investment in any strictly private enterprise in Canada.

Canadians invest more in the Bell Telephone Company, a public utility, than in International Nickel. However, when the total investment in MacMillan Bloedel, the Steel Company of Canada, Canadian Pacific or any of the big ones is totalled, the value of Canadian investment in International Nickel exceeds all of them very substantially. In our case the Canadian investment is in excess of \$1 billion. I think the closest competitor is approximately \$600 million.

Senator Benidickson: And you say you have generated foreign exchange of over \$500 million.

Mr. Wingate: After deducting dividends paid abroad, purchase of equipment and other expenditures, we made a net contribution in 1968 of \$550 million. Part of that was due to the fact that we had external borrowing in the United States which came into Canada to facilitate our expansion program here. Taking the current trade balance, plus the borrowings, the net benefit to Canada was \$550 million. Without that, if we had just disappeared, Canada would have had a very substantial deficit.

Senator Phillips (Rigaud): Mr. Wingate, before you go to lunch, if it is of any comfort to you, I may say that I am not selling

I would like to say, before we break up, that we have had very many presentations dealing with the subject matter of integration; and I would like to record my personal appreciation of your Appendix G-1, which I regard as a cogently and ably drafted document dealing with the proposed integration plan in the White Paper.

Mr. Wingate: Have any of my co-delegates any point to make at the present time? Mr.

Chairman and honourable senators, we greatly appreciate this opportunity to appear before you. We have done a great deal of detailed backup work, not to prove our conclusions but to arrive at our conclusions. If there is anything which we have said in any part of this, on which someone has a reservation, we would be delighted to go over the backup material with the members of the staff.

The Chairman: Thank you very much.

The committee adjourned until 2.15 p.m.

Upon resuming at 2.15 p.m.

The Chairman: Honourable senators, our first brief this afternoon is from La Chambre de Commerce de la Province de Quebec, and Mr. Alary is going to make the opening statement and then introduce his panel. If there are any features that the members of the panel wish to discuss, they will do so, and then they will be available for questioning.

Mr. Rene C. Alary, Chamber of Commerce of the Province of Quebec, Member of the Executive, Associate of Deschenes, Colas, de Grandpre & Associates: Gentlemen, the Chamber of Commerce of the Province of Quebec believes that the increase in the tax rate from 23 to 50 per cent of the profits of small businesses would not directly hinder their growth. It suggests that a formula be found which would enable small businesses to reinvest as much of their profits as possible. It should also be noted that almost all businesses in Canada, that is small businesses, are owned by Canadians. The Quebec Chamber of Commerce has expressed its feelings about the integration of income in order to avoid double taxation. It is suggesting a simpler method to the government which would consist in deducting dividends as if they were interest for tax purposes. The integration would therefore be complete on the proportion of income distributed to shareholders. The Quebec Chamber has favoured the increase in basic exemptions proposed in the White Paper. It believes that the tax burden of low income earners must be lightened. However, it repeated its opposition to a capital gains tax because it feels that such a measure could be detrimental to the coming into Canada of a great deal of foreign capital which is essential to us, especially in Quebec, to continue the economic development of the country. The Quebec Chamber of Commerce appreciated the statements made by the Minister of Finance, Mr. Benson, who agreed to maintain federal government revenue at the

same level, which is exactly what the Quebec Chamber requested in its brief. In effect, it had recommended that tax reform not be used as a pretext to increase government revenues. The Quebec Chamber recommended to the federal government that it continue to provide the appropriate incentives to encourage mining investments which are of prime importance to Quebec.

In closing, the Quebec Chamber of Commerce asked the federal government to adopt a stable and durable tax system as soon as possible.

Gentlemen, I take the initiative in introducing our experts. To my immediate right is Mr. Guy Charest, adviser, associate of the firm of Touche, Ross & Company, Mr. Victor St-Onge, member of the Board of Directors and chief tax expert for the Quebec-Cartier Incorporated mining company, Mr. Jean Paul Letourneau, general director of the Chamber of Commerce of the Province of Quebec and Mr. Gilles Champagne, director of research for the Chamber. Gentlemen, we are at your disposal for any explanations you might desire about the suggestions contained in our brief.

Senator Desruisseaux: As a preface to my remarks, can I ask you to underline the importance of the Chamber of Commerce of the Province of Quebec in relation to our economy?

Mr. Alary: Well first of all, our movement is the federation of chambers of commerce which groups 261 local chambers of commerce and boards of trade that are active in the Province of Quebec. We have more than 33,000 members and some 1,850 associate members. The brief was prepared by the board of directors with the assistance of its experts and was then distributed to all local chambers which were asked to make comments or suggestions. The brief came back to the board of directors which corrected it accordingly. Therefore the suggestions contained in the brief truly constitute the opinion of all chambers of commerce in the Province.

Senator Desruisseux: Can you say whether the chambers were unanimous in their approval of the brief?

Mr. Alary: The chambers were unanimous otherwise we would be dishonest in presenting it to you, especially if some chamber had

made suggestions which we did not incorporate in the brief.

Senator Desruisseaux: Thank you.

Mr. Alary: Mr. Letourneau could perhaps add something in so far as the federation is concerned.

Mr. Jean Paul Letourneau, General Director of The Chamber of Commerce of the Province of Quebec: No, I think that is exactly what happened except that perhaps the word "unanimous" is a little too strong. Some people who did not express their opinion could be of a different mind but no one made any objection.

Senator Desruisseaux: You seemed to have insisted on the business of people, people who have businesses which are not overly large—small businesses—and you said earlier in the presentation that that especially affected the Province of Quebec in the sense that in Quebec there is a greater number of people with that type of problem. Can you expand further on the statistics which you obtained?

Mr. Alary: I would ask Mr. Charest to answer that question.

Mr. Guy Charest, Adviser, Associate in the firm of Touche, Ross & Company: Mr. Chairman, I do not necessarily have the statistics which would show to what extent the Province of Quebec would differ in relation to the other provinces. We know in point of fact, and I believe that all supporting federal statistics could prove it, that a good part of the industrial and commercial operations and even of business services in the Province of Quebec, is mainly undertaken by small businesses. Several gravitate around a core of large businesses but essentially the economy of the Province of Quebec is rather weak and made up of small units. I do not think it necessary to quote specific figures. I believe it is a recognized fact that small and average-size businesses account for the majority of businesses in the Province of Quebec, the great majority of businesses and activities in the Province of Quebec.

Senator Molson: Do they favour the present system or do they want to replace that system by something else?

Mr. Charest: Well, the Chamber specifically recommends the preferential rate on the first \$35,000 profit...

Senator Beaubien: 21 per cent?

Mr. Charest: That the 21 per cent be continued for small business. We believe that that can be attained in various ways so as to really limit the preferential rate to small business alone. A graduated rate could exist over and above \$35,000 profit until the business, realizing a profit say of \$100,000 or more, has repaid the \$10,000 reduction allowed it on the first \$35,000 profit.

Senator Beaubien: Mr. Charest, in your opinion small business realizes at least \$100,000 per year. Is that what you are saying?

Mr. Charest: I did not attempt to define small business.

Senator Beaubien: I should like you to attempt a definition. If recommendations are to be made, it must be decided and stated exactly what small business is.

Mr. Charest: Small business can be measured in terms of its concern. It could also be measured in terms of the number of its employees, its turnover, the capital it uses. We did not carry out a study to determine just what a small business is. However, I have read several comments on the subject where it was claimed that in view of the inherent difficulty in defining small business, the problem there would be in defining small business from a taxation point of view, all companies should be dealt with in the same way and then later small business could be distinguished by other means. However, I contend that it would be just as difficult to determine what small business is at the time said business is to be compensated for the additional tax burden...

Senator Beaubien: The same problem then.

Mr. Charest: The same problem exists and I believe that the very nature of the Income Tax Act offers a much more specific means of assuring the same treatment, an equitable treatment, to all taxpayers. The White Paper puts forth the equity principle and I think that just as important is the finding of an equitable formula to favour small business, even if other formulae have to be resorted to. I think that the means now available to the Department of Revenue are likely to provide greater equitable treatment than would the creation of other services which would have to gain experience and define their terms of reference over a number of years.

M^r. Alary: Perhaps Mr. Letourneau could complete the answer?

Mr. Letourneau: For the moment our organization's official position is that better definitions are needed and we accept no definition other than that already established by the Income Tax Regulations, \$35,000 income, that is the definition...

Senator Beaubien: Of profit?

Mr. Letourneau: Of profit, that is.

Senator Beaubien: Mr. Letourneau, suppose a company realized \$45,000 yearly, what would you recommend in that case?

Mr. Letourneau: There is a regulation at present...

Senator Beaubien: 21 per cent of \$35,000?

Mr. Letourneau: Of \$35,000. We accept that regulation for want of a better definition and we recommend that it remain as such. The proposal is that a uniform rate be established for all types of businesses. We object to that proposal and we want the present system, which gives a tax advantage to businesses realizing at least \$35,000 in profits, to be continued.

Senator Beaubien: The disadvantage in your system, Mr. Letourneau, is that today companies which realize five or six million dollars have the same advantages with respect to the \$35,000. Therefore it costs...

Mr. Victor St-Onge, member of the board of directors, chief tax expert for the Quebec-Cartier Incorporated Mining Company: I should like to elaborate on that question. I am quite familiar with certain businesses and I must say that it is not at all an economic necessity for big business to benefit from the preferential rate of 21 per cent. Therefore it would surely be agreed that the preferential rate be restricted to small businesses. As you pointed out, it is a matter of defining small business.

Senator Beaubien: Some kind of formula?

Mr. St-Onge: Yes, a formula. I think that it is basically possible. Already, other legislations in the area of small loans, in the area of corporation and labour unions, in the report there are standards which have been determined to indicate, to differentiate between small and larger business. I think three or four criteria would certainly suffice to determine a small enterprise. One would be the gross revenue. Certain legislations—the

corporation and labour union legislation—indicates that \$500,000 in gross revenue—if less than that there is no report to be made. This would indicate that is considered a small business.

Another is the assets, the gross assets or the net assets of an organization. \$250,000 is another criterion which has been used there. I am not familiar with the criteria used for the small loans, however, but the municipalities have a criterion with respect to the number of employees and the different rates of municipal licences. Therefore, I think there are bases which can be arbitrarily fixed and agreed to which would then enable a distinction for small businesses that would be entitled to that preferential rate.

Then there is always the possibility of having a tax provision whenever the small enterprise becomes bigger, because, on the one hand, if there is a tax provision to encourage small enterprises I think the same tax legislation should encourage small businesses to get bigger.

This is the basic request for that preferential rate, to get small businesses big enough to continue to get bigger and therefore be able to pay their fair share of taxes as paid by the big businesses. Also, by getting bigger, all governments will get more revenue, and this is why the chamber feels that small business needs that encouragement in order to grow and as a result of such growth, everyone will profit—owners, employees and all levels of government.

Senator Beaubien: It would be a great help to us Mr. St-Onge if you would be so kind as to give us your formula and give it to us precisely so that we may have something to put down when we write our report.

Mr. St. Onge: Well, if Mr. Benson wants to hire me to draft his legislation, I suppose that by that time I could probably devise some formula to get over the other experts, but at the present time I think whatever I could propose would certainly not be agreed upon by many other people so one would have to take some kind of consensus in that area.

Senator Molson: You are among friends in this committee.

The Chairman: Small business under the Small Business Loans Act was originally defined as a company that had sales of not more than \$250,000. At a subsequent date that was set at \$500,000.

We have had people here who have said that anyone with \$75,000 to \$100,000 net profit would be in the category of a small business.

Mr. St. Onge: I would think net profit would be quite a tough criterion to use because of the capital cost allowances and deductions which were available in earlier years.

Net profits in books, as you know, is something different than taxable profit for tax purposes. Tax legislation should necessarily refer to taxable profit. Big businesses often have no taxable profit for a number of years if they have large write-offs and can then be considered as small businesses, if this is the only criterion used.

The Chairman: Yes, but if small business doesn't earn any money; 21 or 100 per cent doesn't make any difference in the rate. They have nothing to pay, so when you talk about net profit before or after taxes, the only difference would be, what taxes?

Mr. St. Onge: Yes, and what kind of accountants you have, and what firms you have to prepare your accounts.

The Chairman: I would not be familiar with that. Maybe you could tell me.

Are there any other questions on this? There are some aspects of small business about which we wonder if you have given thought. A proprietor grows older, as everybody does, and in the course of operating his business, instead of building up a pension or retirement savings plan for himself, he puts his retained earnings into the business so, in effect, his pension for his retirement years is in the business. Well, he gets older and he wants to sell out. Then you have another problem there if there is a capital gains tax.

Have you given any thought as to whether or not it is equitable that there should be a capital gains tax to apply to small business in those circumstances?

Mr. Alary: The Chamber of Commerce brief is opposed to a capital gains tax. I think that the example given by the Chairman is a typical case where capital gains should not be taxed. Mr. Letourneau, can you add anything on the matter?

Mr. St. Onge: Do you want a minority report?

Mr. Charest: Mr. Chairman, if you would permit me, I would suggest that the position of the chamber has been made quite clear in the brief which has been submitted. The

Chamber recommends that there be no capital gains tax. However, if the consensus was that there should be a capital gains tax in Canada, I believe that one of the factors that should be taken in account in determining the extent or burden that the tax would create is the period of time during which the investment or asset has been held.

I think the case you just mentioned of a sole proprietor who has operated a business for a good many years, perhaps the major part of his life, should not be treated in the same way as an individual who speculates on the stock market and sells after a few months.

Possibly the rate of taxation should decrease with the number of years an investment has been held.

The Chairman: That is making it a bit complicated. Why would you not go for the simple proposal or proposition that, if a proprietor sells out, looking towards retirement, any gain he realizes that he pays into a retirement pension fund be non-taxable? He only pays taxes when the money comes out. Would that not be a reasonable position to take?

Mr. Charest: Certainly this would alleviate difficulties.

The Chairman: There is further difficulty that I think the small businessman has; we are interested in the small business, believe it or not, as the committee and the Senator Phillips (Rigaud) and other senators will tell you.

If a small businessman is overtaken by death before he has a chance to do this, then then there is the problem that a capital gain is generated in the estate when they are trying to realize the amount of estate taxes.

Now, the White Paper proposes that the beneficiary who receives the assets pays no capital gains on that gift at that time, but only when the beneficiary disposes of it. At that time the cost is a cost to the person who died, and any difference is capital gain and subject to a capital gains tax. We have considered other ideas. This would not apply where the proprietor dies and his estate has to sell the interest in order to pay the estate tax.

If the capital gains tax applies there, why should it not be a credit on the estate tax?

Mr. St. Onge: Or elimination of the estate tax altogether.

The Chairman: We are studying the White Paper, which does not directly take us into the area of estate tax.

Mr. Alary: The position of the Chamber of Commerce of the Province of Quebec on the question of succession duties is that the duties belong to the provinces. That is its decided opinion. To get back to the question of capital gains, it is of interest to point out here that that stand was taken by the federation of Chambers of Commerce at a convention in 1969 when the White Paper had not yet been published. It must be recalled that the members of the federation of Chambers of Commerce are owners of small businesses. In that sense it is important to tie in the notion of small business with capital gains. The stand taken was firm, unanimous and without contradiction. I do not know whether the same thing would occur in two years or in five years. It might be different. However, in 1969, in September of 1969, that was the position taken before publication of the White Paper.

Senator Molson: Under those circumstances we should accept that as a categorical statement of position that they are opposed to the capital gains.

The Chairman: It is a categorical statement of position. However, in law we have what is known as taking an alternative position just in case the first one does not succeed.

Mr. Alary: The alternative solution, agreed. However often the alternative solution is not the ideal.

Mr. Gilles Champagne, Director of Research: Mr. Chairman, the economic situation being what it was and the need for capital immense compared to other provinces, at the time the capital gains tax policy was adopted, for the Chamber of Commerce it seemed that it was important to continue that incentive. It was an incentive for foreign investors when it is realized that in the Province of Quebec more than seven billion dollars must be invested annually to maintain the rate of development and at present the investment rate is \$3,500,000,000 in investments. An incentive had to be continued to be offered and that was one incentive. I think that when there is an incentive as important as capital gains will be, then the Chamber of Commerce members realized that it was important. As the president, Mr. Alary, said, that is why they came out categorically against the taxing of capital

gains and took a strong stand since at the present time Canada needs that kind of investment.

Mr. Alary: As an alternative solution, if alternative there must be, it is important that the capital be left in the business. If it is taken away by way of taxes, then the business no longer has it. However if it is to be recovered by a long, complicated and often inefficient process, then it is important that it be left there to enable the business to develop. If a so-called ideal development rate had been found, it would perhaps be possible to take that capital away from the business and give it to the Government and then later recover it in another way if small business is to be protected. However we feel that it is essential that the capital remain in the business. It must remain in small business in order to allow it to continue to expand. Therefore, Mr. Chairman, the alternative does not allow much latitude.

Senator Beaubien: It is rather difficult to leave the money there.

Senator Molson: That would suggest, Mr. Chairman, that if there were an alternative, in the view of the Chamber it would be based on the question of pay-out.

As long as profits remained within the business there would be some incentive given to the small business to maintain their funds within the business.

The Chairman: Since 1949 there has been a tax which started at 10 per cent and has increased to 22 per cent, 21 per cent plus one per cent on the first \$35,000. This has enabled retained earnings to be kept in the operation and used for expansion. That is the method by which a small business obtains its capital.

There is no problem in taking it that far if the Chamber of Commerce says they favour continuation of the 21 per cent tax on the first \$35,000.

The problem arises when the proprietor grows older and does not wish to carry on the operation of the business. He wishes to provide for himself and his living. He may die, leaving estate taxes and other expenses to be paid. Then you have to consider the problem to the son, relative or stranger taking over.

If there is a capital gains tax in those circumstances I certainly have the view that it should not apply or, if it is an estate, there should be credit on the estate tax for

the capital gain. In that way it lessens the burden on the estate.

You know, sometimes you have to settle for second best.

Mr. Alary: However, you know that in the Province of Quebec we witnessed—the tax on succession duties brings in little compared to other taxes—a break-up of family businesses precisely because a revision of business structures was imperative. So, if another method of taxing capital gains, periodically or at a specific time, is introduced, once again there will be a break-up of small business in a shorter period of time. Big business is capable of facing up to those problems. Small business, in the face of all those technical difficulties, is forced to disappear, to sell or to remain controlled by other businesses, the competitors.

These are the views which were expressed during the preparation of the brief by, once again, a group of proprietors. And we are not here to protect only small business. We represent large businesses, needless to say. But this is a sector which in this field must in particular be protected, it seems to me.

Senator Phillips (Rigaud): Let us say that we shall have a special tax for small businesses. As soon as the profits are divided among the parties concerned, do you think that we shall have to pay a tax as individuals?

Mr. St-Onge: Do you mean if the dividends are declared or if they can elect to have the partnership proposal?

Senator Phillips (Rigaud): No. Suppose there is a small corporation which has been subject to the 21 per cent tax. Profits have accumulated, no tax has been paid and subsequently a distribution is effected.

Do you think that the recipient shareholders should be obliged to pay a tax in respect of those corporation profits which were not subject to tax?

Mr. St-Onge: I would think in equity. I have no small business of my own, nor large for that matter. Certainly if the low rate is given to encourage the small business there should be a time of recognition somewhere with, however, provisions for l'étalement des revenus or, as was mentioned, the possibility of investing in a pension plan without depriving these people of a great part of the 50 per cent of the earnings accumulated over the years.

However, I think a certain proportion of it would in equity have to return to the estate. This is a personal view, which is not expressed in the Chamber's brief and with which my colleagues might disagree.

Mr. Charest: Mr. Chairman, I believe that the question involves two principles which are contained in the White Paper proposals.

First of all, there is the question of how long should we permit the company to pass on the creditable tax to its shareholders?

Senator Phillips (Rigaud): No, leave that out completely. Let us assume that we have no integration under the White Paper and are simply dealing with special rates of taxation for small businesses under our present system.

Mr. Charest: In those circumstances I believe that the present provisions of the act with respect to surplus distribution should still be available to the shareholders.

The Chairman: You mean the 20 per cent tax credit.

Mr. Charest: Yes, and also the provisions of section 105 for the distribution of accumulated surplus.

The Chairman: You think that would be satisfactory?

Mr. Charest: Yes.

Senator Phillips (Rigaud): So that would be sufficient imposition of tax, the 20 per cent tax credit or capitalization under section 105.

Mr. St-Onge: Or 25 per cent tax credit, as was suggested.

Senator Phillips (Rigaud): Or if it were increased, yes.

Senator Molson: Twenty per cent.

Senator Phillips (Rigaud): Or, if it were increased.

Mr. Charest: Again, Mr. Chairman, if you permit me, where we discussed before the question of second best, and although the chamber is formally opposed to any forms of capital gains taxation, I did mention that we felt that the period of holiday should be taken into account. Also, I believe that there are two other factors, one being the taxation of goodwill, as is proposed under the White Paper, which would involve some retroactive

taxation. We believe that this is most undesirable.

There is also the question of the transition period. If a business were to be sold in the first few years, the tax bite would be much higher than if it were to be sold in the last years, since the rate would not yet have reached the lower level that is proposed, the 51 per cent or the 20 per cent that was proposed in the fifth year.

Certainly, there should be a way of taxing these capital gains in the first few years, on the basis of separate calculation, so as not to penalize a proprietor who has operated a business for a good many years. Because he has to sell or decides to sell and retire in the first, second, or third year, he would be called upon to pay quite a heavy burden of income taxes, because of the proposed integration of capital gains and other income.

During that transition period, due provision should be made to avoid such a heavy burden.

The Chairman: We are interested in what you say on that point, but we would like to get an expression of opinion on the assumption that integration does not take place.

Mr. St-Onge: In that case we should reserve at least a 20 or 25 per cent dividend tax credit, which is there presently. This is one way.

The Chairman: Yes, this is the alternative.

Mr. St-Onge: It has been tried for a number of years and has been pretty successful.

The Chairman: 1949.

Senator Phillips (Rigaud): En passant and, coming from Quebec as I do, you are not thinking seriously of a 15 per cent tax rate at the end of the fifth year are you?

Mr. St-Onge: On the basis of our limited experience in such matters, it is always very difficult to reduce taxes.

Mr. Charest: Obviously, the Chamber's position-account is taken of the fact that the tax proposals recognize that agreement will be necessary with the provinces. We believe that then the Province of Quebec, like the other provinces, will be in a position to put forward its point of view and if that is not specifically stated or if it was not discussed, we take it for granted. It is mentioned at the end of the brief.

Senator Phillips (Rigaud): Mr. Chairman, we would like to get the views of this group with respect to the mining and petroleum industries, which are dealt with at page 10 of the brief.

The Chairman: I think, in passing, senator, we have very little comment on the contemplated proposal to tax the principal residence. We have not heard a single favourable voice to that proposal, except what the White Paper says, so I would not think there would be very many voting in favour of it.

If you are opposed to it, I am wondering if you are also opposed to applying a capital gains tax to the sale of a farm, if there were the limitation that so long as the farm remained in use as a farm, it should not be subject to capital gains tax?

Senator Beaubien: La chambre is against capital gains tax—period.

The Chairman: We are on the alternative now.

Mr. Alary: The alternatives are very, very small.

Senator Beaubien: La chambre does not want to get into that.

Mr. Alary: At least. At least, please. The principal residence and the other necessities of life of citizens in this category.

The Chairman: It is quite easy to make a very good argument against capital gains, in a country like Canada, where savings and investment are such an important part of the economy. It may be that the capital gains tax has got beyond the stage of economics and has got into the stage of a political decision. On that basis, it is an extra source of income; and you know that, when governments see extra sources of income, they latch onto them pretty fast. There may be a large section of the public who do not participate in capital gains and who think it is an excellent idea.

Senator Molson: The White Paper had \$630 million worth of capital gains.

Mr. Létourneau: This is open to everybody, to take advantage of it.

The Chairman: Yes.

Mr. Alary: But, even if many countries found in the modern word have adopted that source of taxes, why should Canada not re-

main a stronghold where capital gains are still possible, simply to allow capital gains to be realized and to help the country's development? That is the whole question. In the Province of Quebec, it is a matter of development. Capital is needed to develop small business. If that capital is removed by the legal means of taxation, then development will suffer. That is the Chamber's basic position.

Senator Phillips (Rigaud): Especially if we intend to keep our resources within the hands of Canadians.

Mr. Alary: That is it. Exactly what is needed for natural resources.

Senator Beaubien: Income taxes are already 30 per cent higher than in the United States. Now you add another on top of everything.

Mr. Létourneau: Mr. Chairman, to promote our stand on the capital gains tax, obviously included in our positions was the economic situation of Canada and of Quebec, its stage of development, its capital needs, the danger for development of our natural resources. However, in view of the fact that we shall be exempted from the capital gains tax, for those persons who want to start a business, a small business, that will be an additional incentive to do so. We regret that there are not enough Quebecers—we do not know what the situation is like throughout the country—but there are not not enough Quebecers who think of going into small business. Let us say that there is too much feeling, that people are looking for too much fast security. This is a regrettable situation and they do not want to eliminate this added incentive. This incentive to go into business, to create small and average-size businesses should not be eliminated. These small businesses will perhaps eventually become big businesses. Therefore if capital gains are taxed, we are going to discourage the young people in our province from starting up a business, from going into business.

Senator Phillips (Rigaud): Perhaps the best solution for us, in the Province of Quebec, would be to have a capital gain in the other provinces of Canada, and not a capital gain in our province.

Senator Desruisseaux: Mr. Chairman, if we are through with this part of the subject, I would like to take up something that is said in this brief.

On page 12 when you discuss public utilities, you appear to take a further stand which seems to indicate that the government cannot take a position respecting public utilities unless an arrangement is made with the provinces. Will you expand on that please?

Mr. Charest: All right. In short, we do believe it is necessary to distinguish between income, dividends paid by public utility corporations and by ordinary corporations. We believe that the agreement whereby the central government refunds 95 per cent of the revenue from that source to the provinces perhaps has grounds. There is a direct relation to the fact that they are public utilities. However, as much cannot be said for other payments, other transfer payments made by the federal government to the provinces. Certainly, most of those payments, whether for education or health care, result all the same from income taxes but no one thinks to say: for such purpose, when we refund money, we shall not grant the full credit. I believe that that is an agreement which has nothing to do with the tax base and, if shareholders of public corporations were treated differently, then in order to attract other capital, higher dividends would have to be paid. That abatement would not exist and as such the cost of services would have to be considerably higher for the public in order to keep those businesses profitable.

Therefore, that is why the Chamber suggests that discussions be held with the provincial governments in order to find a distribution solution, perhaps different, but to continue for the public utility shareholder the full abatement or the same treatment which would be given to other shareholders of all other businesses.

Senator Desruisseaux: You do not know that there were dealings between the provincial and federal governments in that regard. Do you know whether there were any dealings?

Mr. Charest: No.

Mr. St-Onge: I think the same problem would exist with respect to the present 10 per cent of provincial corporation tax on corporation income if the integration proposals are implemented. The White Paper seems to indicate that the federal Government would be the party which would reimburse the full credit.

Now it is not clear whether or not they want the provinces to put their share also with respect to the 10 per cent or the 12 per cent of their own tax. This would also necessitate some arrangement with the provinces if such a system were to operate.

The Chairman: You know, the White Paper contradicts itself when it says that the shareholder in a public utility, privately-owned, is not going to be entitled to any creditable tax, because the theory of creditable tax is that it is related to corporation tax paid by the corporation, and these corporations pay their tax. That money goes into the Consolidated Revenue Fund of Canada. Then there was a special act passed a couple of years ago which takes an amount of money equal to the amount of tax and directs that it be paid to each province. Now there is only one province in Canada that passes that money back to the consumer, and that is Alberta, and they were smart enough to pass a provincial statute, and it must appear on the tax bill of each taxpayer that this individual credit on his bill is by virtue of such and such a statute of the Province of Alberta, so there is some persuasive political power, as you can see; but the other provinces just put it into their Consolidated Revenue Funds. And it is mixing up taxation and distribution.

Senator Phillips (Rigaud): As a matter of fact, Mr. Chairman, the money received by the federal Government from the utilities is not the money that is paid to the provinces.

The Chairman: No, it isn't.

Senator Phillips (Rigaud): The federal Government can borrow the money or use another tax especially earmarked for the purpose of effecting the transfer.

The Chairman: That is right.

Mr. St-Onge: There is this other practical point also, that any individual who received dividends from public companies or other companies shows that on its income tax return, it all becomes one part of credit to a certain extent, and usually that person would normally have a balance of tax which is owing to the Government. I cannot see how segregation could be made of the public utilities credit versus the other companies once it gets into an individual shareholder's tax return and is mixed with the other income on which he has more tax to pay usually than credits available.

The Chairman: You destroy the basis of creditable tax if you enforce or implement this proposal.

Mr. St-Onge: Yes, this would mean that no credit would be given in this case.

The Chairman: Notwithstanding the fact that tax has been paid.

Senator Phillips (Rigaud): Are we through with that, Mr. Chairman?

The Chairman: Yes.

Senator Phillips (Rigaud): Under item 6, you favour, do you not, the increase in the exemption from \$1,000 to \$1,400. Obviously that will cost the federal government one billion dollars, perhaps \$1,200 million. Who will make up those deficits?

I am making the point, Mr. Chairman that if \$1.2 billion is lost in the increase of exemptions, who is going to do the paying?

Mr. Charest: The Chamber agrees that an effort must be made to provide some relief for low income taxpayers. Elsewhere however the Chamber says that the additional burden which will be placed on the taxpayer with an income in excess of \$8,000 may be very heavy and discourage savings. Therefore I feel two alternatives exist. The government could perhaps study the possibility of collecting a greater part of its revenues through indirect taxation, using other sources of revenue and reducing its expenses.

Senator Phillips (Rigaud): Would it not be difficult to reduce expenses?

Senator Beaubien: How do you expect to increase indirect taxes? We already have a 12½ per cent sales tax. There is no such tax in the United States. Therefore we are off to a bad start with an 8 per cent sales tax in the Province of Quebec. That is 20½ per cent already.

Mr. Charest: I remember when the sales tax was introduced. It started off at 8 per cent, then increased to 10 per cent and so on and so forth. At the different times when there were changes in the tax rate or in the property subject to the tax, all sorts of representations were made to the effect that our economy would be greatly hindered by the burden of such a tax. However, today we have reached a very high rate but before deciding whether we have reached the peak, it would be worthwhile comparing to see

whether we have reached the limit in personal taxes. An attempt would have to be made to discover whether the economic consequences would not be more serious by increasing the individual's tax burden, that burden directly deducted from his income. I think that such a comparative study would better answer the question.

The Chairman: Yes, but you know at \$8,000 or \$9,000 a year of taxable income, the increased exemption is taken back by the increased tax, so that the taxpayer above that level does not get the benefit of the increased exemption. Now it does seem to be what I call an exercise in futility to give him something and then increase the rate to take it back from him. And you find that the increased burden of taxation is between the \$8,000 or \$9,000 a year and the \$24,000 a year. In that you have a very substantial savings group. Now, if instead of extending the exemption to everybody, if they cut it off in the area where there is some benefit in the rates taxed, it might take you up to about \$8,000 a year of taxable income and, if it did not extend the increased exemptions to anybody else because I do not think they want them, at least, not on the basis they are now, that this is all taxed back, you would lose much less tax revenue and, therefore, you would have to find much less new tax revenue. The billion of lost revenue they talk about having to make up is due substantially to the result of increasing the exemption all the way along the line to people who, if they had a choice in the matter, would not take it.

You know where a substantial part of the recovery comes from. Over \$4 million of it comes from changing that 21 per cent rate on small business to the 50 per cent rate. That is where it comes from. So that the low-income earner in direct taxation at individual rates is being helped by the increased exemption but the low-income earner in small business is being hurt if he finds his business rate going up to 50 per cent from 21 per cent to make up the difference. So there are a lot of problems that you have to look at.

Senator Beaubien: I should say so!

Senator Phillips (Rigaud): I do not think, Mr. Chairman, we have discussed natural resources. I think we should go back to that.

The Chairman: Yes, mining and petroleum industries.

Senator Phillips (Rigaud): Yes. On page 10—is there anyone in the delegation sufficiently familiar with the technical aspects of the tax holiday and the depletion allowance to be able to answer some of these technical points that we would like to bring up?

Mr. St-Onge: Well, we will try. I am the Chairman of the Committee of the Quebec Mining Association and a member of the Tax Committee of the Mining Association.

Senator Phillips (Rigaud): I do not whether you were in the room when International Nickel raised the question of the free-tax holiday, amongst other things, being allowed only conditionally upon the opening of a mine in new territory.

The Chairman: Pioneer areas.

Senator Phillips (Rigaud): Pioneer areas, as our Chairman reminds me, being the exact words. Do you think it would be feasible, knowing our situation in Quebec, to apply that principle, and also to apply higher rates of depletion for the opening up of new mines as distinct from those that are presently in production?

Mr. St-Onge: Actually, those ideas have been developed within the Quebec Metal Mining Association. I think it was our summary of the idea that we passed on to them.

I have to start with the statement that the chamber's stand was taken after the publication of the Carter Report. At that time there was no question of studying alternatives, only the question as to whether or not we agreed with the Carter Report recommendations.

This stand was taken at an annual convention of the association and was based on the views of the Quebec mining industry which had outlined the need for such incentives as those that have existed and that now exist.

However, after the White Paper was published, the mining groups in the Quebec Mining Association studied it and felt that certainly everybody should have some ideas as to how a change could be made, which could be acceptable. In the area of the three-year tax exemption we felt there was a possibility of putting some limitations and restrictions on the over-all application because we felt the major reason for the three-

year tax exemption, at least as far as larger developments in remote areas are concerned, was because of the need for investing in social facilities which are paid for elsewhere by the provincial or federal governments.

In our north shore area we have built airports, railroads, schools and hospitals without any support from either the province or the federal Government, and we thought that the three-year tax exemption was legitimate in view of this early and required investment. This was one way, instead of getting the states to do it, to pay for it.

In that perspective we said—and we actually made some recommendations to the Quebec government on that question which is very similar to what International Nickel has made—that there were some limitations that could be acceptable; and that certainly it may not necessarily be a position which would apply to every mine.

We said additional capital requirements were not necessary, but that it should continue to apply wherever—and this is the expression we used—a new mine gives rise or brings development of a new mining incentive; a new mining incentive being a criterion which could easily be applied and would, therefore, involve the building of townsites and all facilities.

But, certainly, without disagreeing with the Exchequer Court or the Supreme Court decision in the MacLean case, I am satisfied with the Supreme Court decision because it makes sense, that the exemptions should not apply to a new ore body which is developed with all the facilities already there, or which does not give rise to a large additional investment, that is, at least in the social area.

Senator Phillips (Rigaud): Does that line of thinking apply to depletion as well?

Mr. St-Onge: Well, depletion is something else. We feel the White Paper proposals, as well as the Carter Report recommendations, have not taken enough consideration of local and provincial taxes to which a large mine is subject at very large amounts which are paid out in school and municipal taxes because of the large investment by mining companies. Mining companies are also subject to additional taxes, such as provincial mining taxes or mining duties or royalties.

Certainly in our calculation, technically depletion allowance is one way of allowing a mining company to be taxed at not more than 50 per cent when you combine the income tax and the provincial mining tax.

Additionally, it is recognized that there must be a certain difference there which constitutes an incentive, and we have submitted—although the chamber has not taken cognizance in its presentation of that submission by the Quebec Mining Association with respect to depletion allowances, we would, like everybody else, like to retain the present incentives which have worked well; but, on the other hand, there could be some change which would be acceptable.

One of the alternative proposals by the Quebec government in its presentation to the Winnipeg Conference—this was also submitted by International Nickel—was a basic depletion allowance of around 20 per cent to take into consideration the fact that the mining duties are not yet fully creditable against income tax. Up to now they have only been deductible, and sometimes partially because certain mines do not have the kind of new exploration and development expenditures which would allow them to generate that earned depletion which other types of mining in certain sectors would be able to generate. However, in addition to the basic 20 per cent, the earned depletion could be used. All, not only a certain amount, of the expenditure of a mining company for a new development should be taken into consideration.

You are familiar with these class 10 assets. They comprise a good portion of a mining company's investment. However, when the investment is in roads, public water and sewage services, an airstrip, dock facilities and railroads, we feel they should be included.

Senator Phillips (Rigaud): The Quebec Government, through its Prime Minister, meaning by that its finance minister, did give effect to the points you raised.

Mr. St-Onge: Yes.

Senator Phillips (Rigaud): Particularly with respect to roads and so on.

Mr. St-Onge: Yes.

Senator Phillips (Rigaud): Were your representations to the provincial government published? Are they available?

Mr. St-Onge: The Mining Association will be glad to present them.

Senator Phillips (Rigaud): When was that submitted?

Mr. St-Onge: In February.

Senator Phillips (Rigaud): Mr. Chairman, it would be highly desirable to have them.

The Chairman: Are you appearing with The Mining Association tomorrow?

Mr. St-Onge: Yes, I will be back.

The Chairman: Good.

Mr. St-Onge: I will endeavour to obtain a copy for you.

Senator Phillips (Rigaud): But quite independent of that, I think it would be useful to obtain the representations made to the Quebec Government.

The Chairman: You overlooked one aspect of depletion. That is that even the White Paper agrees that the mining industry requires incentives. My definition of an incentive is to pay less tax than others. Depletion is one method of recognizing that.

However, it should be a two-way street. Depletion should be continued to the shareholder receiving the dividend. Otherwise, you are giving the benefit to the company in depletion and taking it away from the shareholder.

Mr. St-Onge: This is a great problem, which involves integration. It will be discussed at greater length tomorrow by the other group.

When you give an incentive with one hand and take it away from the shareholder in taxation without recognizing those incentives...

Senator Phillips (Rigaud): I would still like a specific answer as to whether you think it would be desirable to give a special depletion rate to new mines in pioneer areas?

Mr. St-Onge: Yes, I would certainly agree that something additional is required because of the additional cost of exploring and developing new areas.

This is a basic need for the development of Canada, not only of Quebec. Additional incentive must be given to go north to the remote areas.

Senator Phillips (Rigaud): You would do it either through the special depletion rate or, alternatively, on the theory of the cost of the roads and all the extra services needed to develop the pioneer areas?

Mr. St-Onge: We try to give reasons why it should continue to exist. However, as the

chairman mentioned, there is also the risk involved, not only that of finding the mine but the market is a risk. There is also the competitive situation with other countries who grant a special incentive.

I would like to relate that to the small businesses. The buying power for supply and service of the natural resource industry is such that it is a great factor in continuing prosperity. This applies not only to large manufacturing businesses but to small businesses established in the mining community and the surrounding area. It is true that you may not obtain the taxes as fast from a mining company as you would otherwise, but they come from other people.

Senator Phillips (Rigaud): I can only tell you that we would have preferred you, rather than its authors to have written the White Paper.

Senator Desruisseaux: Mr. Alary, are there any other points on which you would like to comment?

Mr. Alary: Gentlemen, the report was written in French and English. It is available to you. If the Honourable Senators do not have any other questions, we do not believe it necessary to insist further. We are here to put forth our representations on behalf of small business and we can also talk of big business, as you were able to see. However, we do not feel that there is any need to attach greater importance to one chapter than to another.

Senator Desruisseaux: I took particular note of your strong stand on the taxing of foreign income and the taxing of non-resident's income. It is perhaps not necessary to go into details but just to have it in the file.

Mr. Charest: Are you referring to the treatment of non-residents in Canada?

Senator Desruisseaux: Yes, just to be more specific.

Mr. Charest: All right. Clearly, at present to think of increasing that rate to 25 per cent seems prohibitive if we consider the treatment given to residents in the countries of origin of the capital. Furthermore, to us such a change seems impractical because its implementation could take many years before renegotiating the agreements with the countries in question and then there would be the renegotiation procedures. We believe that in the meantime material damage might be

sustained, that the investments could be withdrawn because of the possibility of a reduced rate, a 25 per cent deduction, being introduced in the not too distant future. That would cause some foreign investors to think twice before investing. At present, we have agreements with other countries. There is a considerable number of countries and such application, barring a concentrated effort and co-operation by all the other governments, could not come about before quite a period of time and that would cause great material damage to investors in the meantime.

Senator Desruisseaux: You do not seem too much in favour of the White Paper?

Mr. Alary: Senator, perhaps once again we are insisting on paragraph (b) of section 15, we have a great need for capital in so far as the Province of Quebec is concerned. If we do not take all the steps necessary to bring that capital here by giving it preference, then we shall suffer and development will suffer. That is the conclusion of that paragraph which indicates that there is a need to infuse capital into our largest businesses and it is essential that preferential rights be extended to those aspects of the question, Mr. Létourneau might perhaps have something to add.

Mr. Létourneau: Mr. Chairman, even if it is not stated clearly in our brief, we have said on other occasions through our policies that we consider it essential that any important tax changes, originated either by the federal or provincial governments and affecting the distribution of tax revenues, must be discussed and negotiated between the provincial and federal governments. We recommended and we strongly supported creation of the Standing Committee on taxation. I do not recall the committee's official name but it is the joint committee of the federal and provincial governments. You undoubtedly know its name better than I. We strongly supported formation of that committee. The proposals now contained in the White Paper certainly affect the tax base in Canada. We dearly hope that if the federal government undertakes any major changes, as proposed in the White Paper, those changes will first be the subject of negotiation at that committee level.

Senator Isnor: Mr. Chairman, the Chamber of Commerce is in turn representing the business interests in Quebec. Could any of the witnesses express their views with respect to expenses for attending conventions?

M. Charest: The brief presented by the chamber states that the government intends to restrict the nature of expenses that certain taxpayers are permitted to deduct in calculating their taxable income. There is particular mention of conventions, yachts and social clubs and dues and expenses of this type. We believe that under the existing legislation, if there are abuses they can be corrected. We do not believe that the abuses are as numerous as they would appear to be. In reading through the White Paper, that the number of abuses—as far as everything that exists presently and seems to be the rule—I would like to believe that the number of Canadian taxpayers who have abused these situations is still very limited—although reading the White Paper may convey a different impression.

Senator Isnor: Yes.

M. Charest: I believe that in other fields, the tax department has the tool, where it says that expenses must be reasonable, under one of the sections of the act, they can certainly exercise their judgment in deciding whether or not an expense is reasonable as a deduction from taxable income.

Senator Isnor: Do you think the \$150 mentioned in your brief is sufficient?

The Chairman: That is the employment income.

M. Charest: The test should remain that any expense necessarily and only laid out to earn income, should be deductible, no matter the nature of it, except for the restrictions as to capital goods and so forth, already contained in the act.

Senator Phillips (Rigaud): In other words, sections 11 and 12 of the act are sufficiently relevant for the purpose.

Mr. St-Onge: And any benefit which is personal is additional income and should be taxed to the individual.

Senator Molson: Mr. Chairman, at page 18:

The chamber is of the opinion that the proposed system seems more complex and difficult to apply to Canadian taxpayers. We should have appreciated

proposals for tax reforms which were simple and easily understandable by taxpayers.

Could I ask if that could be re-stated, without changing it, to say that in the opinion of La Chambre de Commerce the proposals of the White Paper are so difficult for Government administration, for corporations, and for individuals that it would present great difficulties to implement these proposals of the White Paper, that it might be difficult to put it into effect.

Mr. St-Onge: I would think it would be more difficult for the Government to get to implement than for taxpayers who have experts to apply it. On the other hand, only those people who have experts can properly apply it. I think the great majority of businessmen who are members of the chamber of commerce do not have a full tax department at their service to work up their tax returns and tax effects of the various moves that they have to make.

True, you get acquainted with new people as well as with the tax system but it may take a long time, if it is asked. I suppose any tax system is complicated. Certainly, we have never said in the past that the present tax system is not complicated, and anyone who would say so would certainly be denying what was said many times in the past. I think the chamber here indicates that there should be ways to remove certain of the complications which exist in the present income tax act, by having better draftsmen to write these things—and I include lawyers among those who many times do not write very well. I am one,—so I know. Certainly, there is nothing difficult in that area and you cannot reach equity and various basic principles in taxation without having some kind of complication.

The Chairman: If the policy is not clearly stated, therefore the draftsman, lawyer or whatever he may be, is not able to understand it and to crystallize his thoughts, then you are going to get something fuzzy, and you do.

Mr. St-Onge: Yes.

Mr. Charest: Mr. Chairman, if you would permit, I would like to say something in answer to Senator Molson's question. I believe that a lot that is to be achieved by the White Paper can be achieved under the present legislation. The elimination of the double taxation of corporate profits could be arrived

at without changing the present legislation, by simply increasing the dividend tax credit and following this accumulated credit in each company just as we would follow undistributed income on hand today and making sure that we did not extend more credit to the shareholders than the corporation has effectively paid in taxes. Certainly this should not present greater problems than what has been proposed by the White Paper.

One of the other factors is the question of taxation of capital gains. Again, assuming that the position of the chamber of commerce of the Province of Quebec is not recognized and that we do have a capital gains tax, may I submit that the number of instances of capital gains is diminishing every year.

The Chairman: Every day, right now.

Mr. Charest: I would say that if we concentrate on the question of sales of shares, this is possibly the bulk of the capital gains that is not presently being taxed. There have been some discussions about taxation of capital gains on land and real estate. There are very few of those left, so even under the present system, it would appear possible to bring these under the tax umbrella without changing everything else. The exemptions could be changed and the tax rates could also be changed without having to rebuild a new act entirely with all the uncertainties that would be revealed in the future.

Mr. Alary: In the real estate field, for example, we have at most some one hundred professional valuers in the Province of Quebec. If real property is to be valued periodically, those persons will be working overtime for many years to come and one cannot imagine it being done correctly.

The Chairman: This appears to cover the subject matter. I want to thank you very much. We have had many representations on these points and we will certainly consider them.

Mr. Alary: Thank you Mr. Chairman and honourable senators.

The Chairman: Now honourable senators, the next submission is from the Chemical Institute of Canada.

Honourable senators, you have the brief before you of the Chemical Institute of Canada and now the panel will be introduced to us. Will you do that, Mr. Michael.

Mr. T. H. G. Michael, General Manager, The Chemical Institute of Canada: Honourable senators, we represent the Chemical Institute of Canada which is the national voluntary professional scientific technological organization of chemists and chemical engineers.

The Institute is represented this afternoon by its President, Doctor Leslie Shemilt, who is also the Dean of Engineering at McMaster University. He is sitting on my immediate right. Next to him is Mr. Simmonds, the Director of Science Policy for the Chemical Institute of Canada, and in private life he is in the Corporate Planning Department of Canadian Industries Limited.

The third member of our party is Professor Pierre Grenier, Directeur des Affaires professionnelles et des branches provinciales de l'Institut de Chimie du Canada et doyen de la Faculté des sciences, de l'Université Laval.

The Chairman: And you are going to introduce yourself, aren't you?

Mr. Michael: My name is Michael, and I am the General Manager of the Institute. Dr. Shemilt would like to make an opening statement regarding the Institute and in relation to its brief.

Dr. L. W. Shemilt, President, The Chemical Institute of Canada: Mr. Chairman and honourable senators, we are very pleased indeed to have this opportunity to speak to the brief which has been placed in your hands. We take, perhaps, a little pride in the fact that it is a brief brief, and we hope that our presentation will likewise be of appropriate brevity, because we have three main aspects to present to you this afternoon in areas that concern a scientific and technological society such as the Chemical Institute of Canada. Our membership which is, as Mr. Michael told you, coast to coast involves about 10,000 chemists and chemical engineers, over 60 per cent of whom are in industry. The remainder are in government agencies, in government services and the universities.

Our concerns as chemists and chemical engineers then are found collectively through the C.I.C., and we find that an important area of our ability to practice our profession is inherent in the vitality and the life of such a society as we have. Therefore, one of the areas we are concerned about and to which we have addressed ourselves first relates to the maintenance of the healthy and viable scientific and engineering grouping in Canada. This is

reflected in a number of ways, one of which, of course, has been raised many times with you in terms of what are called convention expenses, but we have not used that term and it is not used, as a matter of fact, by most scientific societies at all. But that is a question of semantics, of course. We use the terms conference and symposia and so on.

We would simply like to emphasize that in science today and increasingly in science in the future, the ability to transfer knowledge and to transmit from one to another rapidly the new results that are available is carried out to a large degree through our ability to meet in scientific symposia and conferences. Just as a quick illustration, at our recent annual meeting in Toronto, at which we had 1,000 Canadian chemists and chemical engineers and 3,000 American guests, 700 scientific papers were presented in a concentrated session. This illustrates the scientific transfer of knowledge. The physicists will meet next week in Winnipeg and will go through precisely a similar type of exercise.

We feel, therefore, in terms of maintaining not just the vitality of our Society, but more important, the vitality of science itself in Canada, that consideration, very serious consideration must be given to ensuring that this is recognized as an appropriate and important part of science. There are other areas with regard to the vitality, as we term it, of the institute we have introduced, not necessarily as a red herring, Mr. Chairman, but simply as an important reflection of how government activities and actions can affect us. The postal situation, for example, affects us because we find ourselves now, after the recent changes, in a situation where a non-profit society such as ours pays 55 per cent higher charges than commercial publishing houses for like distribution. All we are requesting in the regard, of course, is fairness or equity.

One other area that concerns us is, of course, the investment income area for non-profit societies such as ours. Here again we request merely that we be dealt with in the same package as labour unions and chambers of commerce and so on which under the White Paper will be exempt and which under present legislation are exempt.

Our own particular case seems a very small one in terms of revenue. But nevertheless it is an important one, because it is actually equated to our effort to get scientific speakers in various parts of the country. We do what we can in terms of fighting geography

in Canada. We try to ensure that speakers cover the country coast to coast including isolated sections. We have 90 various local groups of the Chemical Institute of Canada from St. Johns to Kitimat, Nanaimo and Victoria on the west coast.

So these are some of the areas that this first point concerning the retention of vitality are concerned with.

Our second main concern, and we feel that is an exceedingly important one, relates actually to how taxation is going to affect science engineering. Because scientific discovery and invention, and its application through development and innovation is an exceedingly sensitive area, I am going to ask your indulgence to use one or two quick slides at the same time as I am speaking, because I think they illustrate more adequately the points I would like to make.

The concern we have, really, in connection with the effect of taxation on science and engineering is that there is a high degree of mobility in terms of invention. Scientific knowledge and scientific invention can be applied in any country and in any market situation at all. So, if we have wrong kind of tax situation, because of this sensitivity and mobility, we are very likely to drive away an increased amount of scientific discovery and invention.

The Chairman: In the form of persons.

Dr. Shemilt: In the form of persons as well as persons with ideas that they will garner later.

The Chairman: Yes.

Dr. Shemilt: So that the other aspect of this shows on the next slide where we emphasize further that the tax dollars can be used to actually effect advantages or disadvantages, depending on the policies followed.

The interpretation of this we can make very briefly because it does illustrate the tax sensitivity for both large and small businesses. The first part of the graph emphasizes up to point 1 a simple basic research area. This shows the accumulated costs and accumulated revenues. Up to that point is the basic research or idea-generation level where the costs are not very much because there is nothing much going on, other than the ideas and acquiring knowledge.

When this starts to be applied in the form of pilot plants, developing plans and building whole industries on it, you move down in

terms of cost from point 1 to 2 where, of course, you have very heavy capital outlays with very little returns. Then your production starts to pour out and you hit the market and cross the line of equal return. You then get into the area of significant accumulated revenues.

Now, the important thing in terms of taxation is this: that already at point 2 through such federal policies as the federal sales tax, we hit some of these developments fairly hard and the concepts involved in some of the White Paper policies will now hit these types of development harder all the way from point 1 down to point 2.

This taxation will be brought in prior to the utilization of the process. The European expense in general is listed at point 3 where taxation is not hit hard until you have a productive unit.

Basically our main point which we wish to bring to your attention is that taxes should be paid on the results of scientific, technological and engineering creativity and not on the process, not on the means of getting there.

Senator Phillips (Rigaud): May I interrupt you, doctor, because I want to get the feel of what you say because it is, of course, very interesting. On point 2 are you speaking from the point of view of the companies that are engaged in these expenditures rather than from the point of view of the individuals who are members of your association?

Dr. Shemilt: Yes, of course.

Senator Phillips (Rigaud): You are identifying yourself with the corporations because you exist in a commercial sense in relation to the corporations.

Dr. Shemilt: Our concern really is in the area of chemistry and chemical engineering as a science and as a technology that is applied by individuals through many different kinds of structure, including small businesses and large corporations.

Senator Phillips (Rigaud): Yes, but at point 2 you are discussing the problem—

Dr. Shemilt: Of course.

Senator Phillips (Rigaud): —of expenditures of corporations that under the White Paper provisions may not be allowed as deductions. Is that correct?

Dr. Shemilt: That is correct. Small businesses would be influenced much more here

because in many cases the ideas that are developed by individuals or by small businesses are then taken up and applied by the larger corporations that have the engineering skills and capital availability to enable them to come in here.

Senator Phillips (Rigaud): I am sorry I interrupted you, doctor.

Dr. Shemilt: It is quite all right, sir.

The Chairman: With respect to the membership in your association, I note that you are moving over into corporate expense. I wanted that clarified.

Dr. Shemilt: That is very pertinent.

The Chairman: I take it that the members in your association are engaged and identified with various industries and other operations, and even with Government services. In their membership in the association or institute, what do they do as distinct from their vocation that occupies their time, Government service, business or industry?

Dr. Shemilt: I suppose essentially the situation is this: scientific societies have existed and continue to exist because they provide the media for a mutual exchange of knowledge and the development of knowledge. Scientific publications are one. For example, we publish the *Canadian Journal on Chemical Engineering* which we could be glad to give to each of you a copy if you promise to read it. When you have it filled with equations and so on it is a different matter, but this illustrates precisely a group collectively which is able to pass on to each other, as rapidly as our media can permit us, information that can be used in their employment, whether they are analysts in Government laboratories or designing plants for large companies or teaching students in a community college or university.

The Chairman: It is an educational process

Dr. Shemilt: This contains a great deal of science because science is a continuing education. I believe, sir, that the Canadian Medical Association, for example, emphasizes this very point strongly in terms of any profession of the necessity of continued education. It is equally important in science and in chemistry.

The Chairman: This is collective information then, that you have from your studies, that you exchange. If you were called on by

an industry for advice, then how does the institute function at that time?

Dr. Shemilt: The institute is only involved really as a place for the exchange of information which concerns not only science and scientific education, but it is updating and indicating reasonable standards in education and, therefore, it is primarily, I suppose, through its conferences, symposiums and publications, ensuring that our members are able to practise their professions at internationally accepted levels. I think that is really it.

The only way to keep science in the mainstream internationally is to ensure that you have viability, and our weight on the world standards can be done through this means I have mentioned.

The Chairman: Tuning in on the world wave length.

Dr. Shemilt: Yes.

The Chairman: How does the institute support itself? By membership fees, or does it make charges for services?

Dr. Shemilt: No. It makes charges for services in the area of publication, but it is entirely a membership fee organization and is similar to, in this sense, the bulk of the professional organizations in the country.

Senator Carter: Mr. Chairman, before the graph changes, you spoke of the White Paper proposals which would hit that graph much harder. Have you got anything to show us? I suppose you have reached a point at which they would hit harder at an earlier point in time and would go much deeper.

Dr. Shemilt: You might not reach it earlier because this time scale is based on how fast you can get the process into production.

We have tried to do this qualitatively because each cost, of course, has separate quantities associated with it, but your conclusion is essentially correct. For example, in small businesses where this type of presentation is applicable with a reasonable dollar scale, the changes that are being proposed are the ones that are going to hit harder with regard to the development of a new process or getting something new into production.

It is important, of course, to realize that primarily in the chemical and process industries that one is always dealing with the possibility of new processes. One only has to look back ten or twenty or thirty years to

see what was not being produced to realize how pertinent it is, so one is always concerned with getting new things on stream and new products out, so this can hit them unfavourably.

Mr. Simmonds is a bit involved in this and he may wish to add a few remarks, Mr. Chairman, with your permission.

Mr. W. H. C. Simmonds, Director of Science Policy, The Chemical Institute of Canada: Every society must have a mechanism for introducing new ideas, products, processes and applications. Therefore, if you increase the tax load in this area or introduce delays, for example, you have to get Government grants and this delays it, then you are making it more difficult for your particular society to acquire these new ideas.

As we still live in a competitive world it seems unwise to handicap ourselves in in this area. There are alternative policies whereby the same tax moneys could be collected at a later stage when the innovation or invention has proven itself to be successful.

This is the point we wish to make: why handicap our own activities if there is a reasonable alternative?

Dr. Shemilt: Perhaps we could show the next slide. It in a sense sums up the situation in this particular area. The graph illustrated what one can call a tax push that tends to either push industry out or down. We are also always in a competitive market situation with markets much larger than those in Canada. If we have a bad combination of tax push and market pull we will be in very serious trouble. Tax policies should be set in such a way that their effect on science and engineering as it is applied will be understood beforehand. Tax policies do not exist in a vacuum. They affect this kind of situation.

Our final point simply relates to our feeling that tax policy must be based on overall national goals, and not be an isolated type of policy.

Science and technology to a great degree are the basis of economic progress. We have learned how to use them for economic growth. We are learning how to use them for environmental control. We must learn how to use them more adequately for social purposes. In this sense we feel that tax policies must be considered in the light of science policy, which is being examined very exten-

sively by the Government, your Senate committee, and so on.

We fail to see how they can be separated in terms of national welfare. When one sets national goals as suggested by the Economic Council of Canada and the Science Council of Canada, tax and science policies must be integrated to ensure that we obtain the right type of benefit.

The Chairman: Doctor, where has the White Paper offended against the principles that you have enunciated?

Dr. Shemilt: There is emphasis very frequently referred to in terms of tax equity. We feel that tax equity must be considered in terms also of ability to produce taxes. Utilization of science and technology, properly carried out, can contribute to this immeasurably.

The Chairman: Do you mean that economic growth and tax policy should be harnessed together?

Dr. Shemilt: That is correct. We are speaking generally here. You have had some specific examples, such as International Nickel and others, speaking with respect to their processing industries. We are speaking generally as chemists and chemical engineers in the whole science policy area.

Senator Phillips (Rigaud): We agree that it would be absurd to associate the type of work you do, meeting in your scientific studies and exchanging ideas between trained minds, with an ordinary type of convention where the word is given some connotation that it is not too attractive.

You have a sympathetic audience on that score, as you have with respect to the investable income, that you could be identified with the other organizations such as labour unions under section 62 and the subsection to which you referred.

However, the third point, on the general question of deductibility for companies with which you are affiliated, brings you up against a very serious problem. A major part of these expenditures is not necessarily related to the income-producing process of the taxpayer in a given year. That is always one of the problems with the Department of National Revenue.

When the expenditures are incurred in terms of normal business operations there is no problem. However, when you have inves-

tigations made in the realm of pure science leading either to a *cul de sac*, to nothing, or to the ultimate acquisition of a capital asset that you never had before, polarizing it either to nothing or bringing into existence a capital asset such as a chemical process, the argument is that these expenditures that you have incurred, if they lead to a nothing are not an expense incurred in the income-producing activities of the taxpayer and hence not deductible according to our system of taxation reflected in the Income Tax Act.

Per contra, if you are successful as a result of your highly scientific activities and end up with a very important capital asset which ultimately is used to produce taxable income, the expenditures incurred to bring the capital asset into play are not an expense incurred in the course of the year related to the income-producing activity of the taxpayer.

The Chairman: How are we relating it? Are we considering the industry which may have its professional members attend these seminars and whether in those circumstances that industry has the right to deduct the expense incurred by that person in attending?

Dr. Shemilt: This relates to research and development expenditures. This in a sense is not directly involved in the White Paper proposals. Rather it is a separate area, to which we would be very glad to speak at any time. However, there is an aspect in which one has to be careful. If you come back to the individual attending scientific conferences to which the company sends him because they know they will obtain value, this is part of keeping him up to date and bringing in ideas.

However, it really is just a question of going around in a cycle. At what point do you pull out the dollars? You may get into another tax year with it. At present it can be deducted as a legitimate part of business expense. If it is not then it can only be taken out of net income later.

Senator Phillips (Rigaud): Doctor, there is not much problem in convincing this committee that when the individual himself lays out money to go to the type of conference to which you have referred such deductions should be made in respect of his personal income or the corporation itself assisting in the expenditure.

The big problem arises, particularly in the new society that we are developing and the speed of technological change, as to whether the fortunes that have to be spent will stick

to your industry. Can they necessarily be related on an annual basis against the profits made in a given year?

The very point that you have made, that it goes down below the line in terms of capital expenditures in order to create a capital asset which gives a taxable income above the line is the crucial point. Should the capital expenditures incurred below the line be regarded as an expense against the income in a given year, even though in strict business computation or in strict tax law it is pretty hard to relate the income of the taxpayer to that capital expenditure, because when you reach that area the Government tries to help out by capital amortization, and that sort of thing, or by incentive sections under the Income Tax Act. You need those incentive sections because they would not flow by way of deduction from sections 11 and 12, do you think? But when you get beyond that point of saying, without chemical advance with the rest of the world, there should be deductions allowed in a given year, one might well say that all expenses incurred in fashioning good citizenship, in a given year, should be allowed as an expense, because unless we get quality Canadians we will simply go down the drain, competitively, with the rest of the world. It gets into that grey area.

Dr. Shemilt: I think I can understand, sir.

Senator Phillips (Rigaud): I think your philosophy is 100 per cent right. But on the question, other than convention expenses etc. etc, beyond incentive legislation specifically provided for, and capital cost allowances—which at least according to the White Paper is almost one of the few things that you can cheer for. Even though it is the very thing I was referring to, I cannot see any further relief could be given.

The Chairman: How has this question arisen? Has a member of the industry attempted to deduct an expense of attendance at a seminar and been disallowed?

Dr. Shemilt: No, this is still in general permissible but in the White Paper the change will be made in the general convention area and we are concerned and I think, as Senator Beaubien has said, there is a distinction...

The Chairman: If you do not come under the heading of conventions and entertainment and if you do not have to use yachts in order to entertain the people who are attending, you would hardly come within the language that they have used there. Is that right?

Mr. Simmonds: Mr. Chairman, we would like to be specifically excluded. The tax people have a way of working outwards to include anything that is not specifically excluded.

The Chairman: That is supposed to be the expert way of writing a definition. You say it "includes". You do not say it "means". You say it "includes". We see that point. The other point was the income on the investment fund that you have.

Dr. Shemilt: We feel this is simply again one part of retaining a vital and healthy society. We tend to use ours in our particular kinds of operation by ensuring what we call tour speakers for moving scientists around the country. Our concern is that if we do not, in various regions you are going to get an equilibration of ignorance instead of an accumulation of knowledge.

The Chairman: How did you accumulate this? Is it the result of donations?

Dr. Shemilt: As a matter of fact our example is perhaps almost a little ridiculous except that it is general to a number of societies. When one operates as we do on a membership basis and membership fees are paid annually, then one has, at the beginning of the year, a fair bank balance which, on short term investment, bring in to us several thousand dollars. This we can use. Under the terms proposed, this would be taxable. This is basically our trust fund. We have a small trust fund from donations, which is used for this specific scientific tour speaker proposition, and for prizes to students in universities, and so on. All of this would end up as taxable. All of our societies—when we say they are non-profit, sir, they are very definitely non-profit and non-surplus in many instances. One is operating usually on a very close balance. One does not raise fees unless one can justify them in broad terms.

The Chairman: But you end up at the end of the year by spending all the income that you have, do you not?

Dr. Shemilt: Yes, we do.

Senator Burchill: May I intervene? I did not understand. You asked a question as to whether the White Paper "offended"—which I thought a very good word. I did not get the answer to that. I took it that the White Paper did not offend in any particular. Is that correct, doctor?

Dr. Shemilt: I think our concern really here, Senator Burchill, is that there is in-

adequate consideration in it of items that we feel must be taken into consideration. That is, how do we utilize science and engineering in the development of industry and economic growth. So it is really to the inadequacy of it that we are addressing ourselves, more than anything else.

Senator Burchill: Right. Could I go on to a further question, and refer you to the last recommendation in your brief:

The C.I.C. therefore recommends that one of the basic political needs of Canada during the seventies is to learn how best to harness science and technology for economic growth and social needs; and that these broader goals, rather than the more restricted aim of tax equity, should guide Canada's tax policies.

Is it my understanding that you feel that the White Paper should include a specific clause to carry out that recommendation?

Dr. Shemilt: We are really saying that tax equity, as defined in the White Paper, as an end in itself, is not good enough, that tax policies—and, if you like, certain aspects of tax allowances or incentives or tax disparity, under certain circumstances, when it leads to economic growth—is a more important and broader goal.

Senator Phillips (Rigaud): May I, doctor, probably supplement what you said to Senator Burchill? Basically, what you are afraid of under the White Paper is that your conferences will be assimilated to conventions of the type that are contemplated for disallowance from the point of view of expenses. And, secondly, that your investment income might not be included in the exempt income under section 62. And you are afraid that the wording of the White Paper drags you into the ordinary convention aspect from the point of view of the individual or even of the company and, secondly, that your investment income might not be continued by way of being exempt, as it now is, under section 62?

Mr. Simmonds: Those are the specific items which affect us, but we are also concerned with the general situation. I, for example, cannot equate tax equity with social equity. If you alter all the tax structure in Ontario, will you help somebody in Newfoundland? It does not follow from the White Paper what these connections are. Therefore we put into this White Paper the implications that science and technology can be used in

the future in Canada, in ways in which they have not been used in the past. In other words, we have a potential future for this country in such fields as looking after the environment, and potentially in the area of social equity.

Senator Phillips (Rigaud): The danger of that is that you are really getting into a philosophical domain here that is not necessary to meet your current tax problem. I may take the position as a lawyer that in contributing to the cohesion of the citizenry of the country to the best of my ability I am avoiding anarchy and because I am avoiding anarchy, business and commerce including science is allowed to function and I am entitled to greater consideration. So, although the subject matter is interesting philosophically, I think it is getting us away from the main point. But you do have other points that are relevant.

Dr. Shemilt: Yes, we are taking two points, the one being, if you like, self-protective in the first instance, but secondly we do feel that these other questions should be asked in terms of overall tax policy.

The Chairman: You know the original definition of equity was that it was a policy or device that was worked out centuries ago in the courts in order to relieve the rigor of the law. Very often where the law said that you should not do something, very ingenious judges thought in certain cases the full rigour of the law should be not be applied, and so they worked out a more equitable doctrine.

Senator Phillips (Rigaud): Or a more modern version would be that a more equitable tax doctrine is one that would be agreeable to a certain type of taxpayer but the benefit of which should not be radiated outwards to others.

Dr. Shemilt: I might remind you, sir, of Edmund Burke's famous statement that "to tax and to please is not given to any man."

Senator Carter: Before we leave this philosophical question, you mentioned about the need or the desirability of harmonizing tax policy with science policy to achieve national goals. Now are you satisfied with the present taxation system in that respect, or can you give us some ideas where our present system could be improved to achieve these goals?

Dr. Shemilt: Well, in the area of science policy, one of the areas that is under very careful consideration at the present time is what kind of tax incentives to use for research and for development and for innovation which brings processes up to the production point. And in this area, certainly, there is a very important interface with tax policy. Some of the experiments that have been tried in recent years have had very limited success, and the problems that the Science Council is addressing itself to, among other groups, at this stage is precisely in this area. We have been participating at the Chemical Institute to a certain degree in this. We did for the Science Council a complete study a year or two ago on chemistry and chemical engineering research and development in Canada. And the Association of Physicists did it for physics in Canada. In other words, the societies are drawn on when this type of basic information is needed on which science policy can be built.

The Chairman: All that illustrates the character of your work and the character of your performance at meetings which would disassociate you from any relationship to conventions and yachts or entertainment. Thank you.

The Chairman: The next presentation is a submission by the Trans Canada Pipelines Limited. Senator Phillips (Rigaud) is going to take over at this stage.

(Senator Phillips (Rigaud) took the Chair.)

The Acting Chairman: Honourable senators, the Trans Canada Pipelines delegation is headed by Mr. J. W. Kerr.

Mr. Kerr, will you and the other members come forward please?

Mr. J. W. Kerr, Chairman and Chief Executive Officer, Trans Canada Pipelines Limited: Thank you very much, Mr. Chairman and honourable senators. On my immediate right is Mr. G. W. Woods, Director and Group Vice-President of the Company. Mr. Woods is in charge of financial affairs, gas sales and gas supplies. Then on his immediate right is Mr. R. S. Wall, Vice-President and Treasurer, and then next to him is Mr. R. Sim, Supervisor, Taxes.

The Acting Chairman: The policy we adopt, Mr. Kerr, is to receive a general summary of your representations and then you allow yourself to be submitted to a cross-fire of

questions and answers. You will have seen this procedure by now.

Mr. Kerr: Thank you, Mr. Chairman. We are very grateful for this opportunity to express some views on the White Paper on proposals for tax reform.

We believe, sir, that Canada's system of taxation has a significant influence on the economic welfare of our nation. The tax system should provide equitable tax burdens and also incentives for Canadian ownership of our industries and resources.

The goals for tax reform expressed in the proposals are desirable. However, we are concerned that the proposals will not actually accomplish these stated aims. In our brief we have dealt with relatively few areas of the White Paper.

Specifically, we urge that the present dividend tax credit system be retained since it treats all Canadian shareholders equitably. Capital intensive companies are vital to the further development of Canada. The proposed system places these companies, which in their initial years of operation defer the payment of income taxes, at a serious disadvantage compared with more mature, less rapidly expanding companies. The proposed tax credit system is specifically detrimental to the resource and utility industries and will encourage additional foreign ownership, and adversely affect Canadian equity financing.

We recommend that the proposal to tax unrealized gains on public company shares be deleted. It will compound the adverse effects which the proposed dividend tax credit system has on resource and utility companies. This proposal may force investors to sell part of their holdings in order to pay the tax. If a revaluation occurs at a period of particularly high market values, persons in similar circumstances could be treated inequitably.

We recommend that withholding taxes on foreign debt capital be eliminated in order to attract to Canada this much needed and desirable form of capital. Withholding taxes are an insignificant source of tax revenue and increase the difficulties of the Canadian borrower. The Government itself recognizes this factor in that foreign holders of Government Bond issues are exempt from withholding tax.

In summary, we conclude that the proposals will result in foreign investment in expanding Canadian resource and utility companies, foreign investment in more mature Canadian companies will decrease. The proposals will

make it difficult for Canadian resource and utility industries to raise equity capital in Canada.

We hope that the tax reform proposals will be reconstructed to provide a fair and equitable tax system which will contribute to the prosperity of all Canadians and enable Canadians to share, to a greater extent, in our natural and industrial wealth.

Thank you for the opportunity to make these comments.

The Acting Chairman: Would your colleagues like to say something before dealing with questions?

Dr. Kerr: No, I think they are prepared to answer any questions now.

The Acting Chairman: Then, may I, with the concurrence of honourable senators, crystalize a few items here which I think are extremely interesting. They are not in the order in which you have presented them here. I want to deal with one which, strangely enough, has been very lightly dealt with by the taxpayers of Canada as they have appeared before this committee, and that is the suggestion with respect to the removal of withholding taxes on interest payments. Unless I am wrong, I think you are only the second company that has made that suggestion. Senator Molson is nodding by way of concurrence on that point.

I wonder why there has been such a sparsity of support apparently for this idea because when it was first mentioned here by Company X—I say Company X for the moment because I forget who it was—I felt they had a very intriguing idea because we are dealing with the subject matter of trying to gain or recapture part of the equity for Canadians and Canada. The introduction of funded debt from outside Canada would be an attractive way to get the capital back without submerging ourselves too much in the distribution of equity stock.

Have you given any particular study to this concept?

Mr. Kerr: Sir, it is factual to say that in our borrowing of funds to provide for the needs of the trans-Canada pipelines system we have had some experience in direct conversation and discussion with the major lenders of money particularly in the United States, the large insurance companies. I am going to ask Mr. Woods to comment on this subject generally.

Mr. G. W. Woods, Group Vice-President and Director, Trans-Canada Pipelines Limited: Mr. Chairman, we have got to start with the assumption that we believe that Canada is going to require substantial foreign investment in Canada. Through the maximum extent, we can attract this into debt borrowings and this seems to us better.

In our most recent bond issue that we negotiated in the United States, we found great uncertainty by Americans—and I am talking about Americans when I say “foreign”—because that has been the limit of our experience on the withholding tax matter. The investment dealers and the people with whom we had discussions in the United States are absolutely convinced that the market places where people would buy debt securities within the United States, would be substantially increased if there were no withholding tax.

The uncertainty on that issue is such that American borrowers required us to give them what we call a tax indemnification provision in our bonds which, in effect, provides that, if we withhold, which we do now, and they cannot recover it, or if we increase our taxes in any way and they cannot recover it against their taxes payable, we will indemnify them.

Senator Isnor: When was that?

Mr. Woods: This was negotiated in 1967, sir.

The Acting Chairman: Does that mean, Mr. Woods, that on the basis of the present 15 per cent withholding tax they are not too much concerned because they figure that they can get their credit under U.S. law, but that if we were to increase above that, that they might be in trouble by way of U.S. tax credit?

Mr. Woods: That was the position of the ones we talked to, sir. We were advised that we could borrow from others, or that the field would be much broader if we were borrowing on a no-withholding tax basis.

The Acting Chairman: That was the question we put at the time the representations were made by the company that I called Company X, for the reasons I have mentioned. We were given exactly the answer that you have given, that there were certain lenders in the United States who would be more interested in our market for lending quite independent of the existing tax treaty be-

tween the two countries and the reciprocal tax credits that are presently in force at the 15 per cent rate.

Senator Beaubien: Mr. Chairman, the Anglo Newfoundland Corporation borrowed \$500 million and the Canadian Government made the special law whereby there was no withholding tax.

Mr. Woods: That was on their representations and it was necessary to raise the money.

Senator Beaubien: They could not get the money otherwise.

The Acting Chairman: Yes. I am just starting off with this one because this intrigues me very much. I think honourable senators, if I may say so, should be seized with this point when they come, in due course, to consider our recommendations.

Are there any questions, honourable senators? If not, I will carry on. I notice that you start off in your summary with the suggestion that we retain the proposed dividend tax credit. Just to keep our record clear and our files clear from the point of view of those who support the integrated tax system contemplated by the White Paper, and those who do not—I am, of course, assuming from the way you approach this matter that you are against the introduction of the proposed integrated tax system as enunciated in the White Paper.

Mr. Woods: Yes, sir. We think the present system is preferable.

The Acting Chairman: I thought that that obviously would be the corollary of that. I wanted to make that point clear.

Incidentally, in that connection I do not know whether you were here this morning but we listened to the brief of International Nickel Company of Canada Limited and as a matter of interest to you, if you were not here, a good many of us listening to the briefs that have been presented in these many months think that the exhibit the International Nickel Company filed dealing with this very question of integration, which is identified as Appendix G-1, is one of the clearest presentations in support of the argument that one should not follow the integrated tax system as contemplated by the White Paper.

I thought that would be of interest to you as high executives in a very important company.

Mr. Kerr: Thank you very much, sir.

The Acting Chairman: The next question I would like to put to you is with respect to taxes on unrealized gains.

Now, here also I think as far as the honourable senators are concerned, we are sort of flogging a dead horse because we have had quite some number of representations made on that score. None of us are too sympathetic to the taxation on unrealized capital gains, but here again I am assuming you are reconciled to the fact that we will have a capital gains tax and, therefore, your objection is more on the point that there should be no tax on unrealized gains.

Mr. Kerr: Mr. Wall or Mr. Sim, would you care to comment on that?

Mr. R. S. Wall, Vice-President and Treasurer, Trans-Canada Pipelines Limited: I would prefer to have Mr. Sim comment.

Mr. R. Sim, Manager, Tax Department, Trans-Canada Pipelines Limited: Mr. Chairman, we generally feel that a capital gains tax is not in Canada's best interest because of the need for a build-up of Canadian capital. A gains tax will only inhibit this build-up.

We feel that if the general consensus is that a capital gains tax is necessary . . .

The Acting Chairman: Not a consensus, a submission to the inevitable.

Mr. Sim: If such is a fact then unrealized gains should not be taken into account in the tax system.

The Acting Chairman: Can we get the benefit of your thinking along these lines? If we were to have a capital gains tax, some views have been expressed that instead of eating the whole apple that we proceed gradually in the introduction of a capital gains tax in Canada because we are such a young country, sparsely populated and highly involved in export trade, with all the factors that go to the undesirability of a capital gains tax.

So the thought is developing that maybe we should apply a capital gains tax only to the following capital assets. One, securities in corporations, listed or not, and obviously if we eliminate integration we need not bother about the distinction between closely-held and publicly-held companies and all that sort of thing, so I am back to taxation on shares of

companies whether publicly-held or privately owned.

Two, the profit on the sale of land and real estate and three, that it would include the tax on the sale of businesses so far as good will is concerned and the reason for that being that if we were to subject a tax on the shares of private companies we obviously would not want to put an individual or a partnership in a position where if it sold good will it would not be subject to tax.

Some of us feel—it is not important which ones feel that way—that would cover a pretty broad field. As a matter of fact, I think the Quebec Chamber of Commerce this afternoon made the point, not having heard some of the senators previously, that we should probably start off only with capital gains on sale of shares.

Could we get your views as to whether you think it desirable that we proceed slowly over this and cover purely a category of items that would be subject to tax rather than to tax all capital assets and go through this tiresome business of involving ourselves in exemptions such as homes, farms, fruit orchards and that sort of thing and then also having the problem of roll-over, which would be eliminated in the process.

What do you gentlemen think of this?

Mr. Woods: Starting from your assumption that a capital gains tax is inevitable, the slower we proceed the better. The three categories you have enunciated would cover the field very satisfactorily as a starting point and very completely.

The Acting Chairman: It could hardly cover personal effects such as objets d'art and paintings.

Mr. Woods: No, I am thinking of the significant.

The Acting Chairman: And not very many people would take advantage of the non-inclusion. Most will be concerned with investment with the hope of what they will be able to make, rather than with the exemption in taxation.

Mr. Woods: We cannot add very much of significance to your thinking. If capital gains tax is inevitable, the lower the rate to start with and the slower we proceed into it the better.

The Acting Chairman: You are not unresponsive to it as a start?

Mr. Woods: No sir. It has a lot of merit.

The Acting Chairman: Does your third point, of intercorporate dividends, involve merely the retention of the present exemption?

Mr. Woods: Yes.

Senator Burchill: Could we have the witnesses' opinions as to rates of capital gains tax and whether it should be collected separately or integrated into the tax system?

The Acting Chairman: I will be glad to do so, Senator Burchill. Opinions have been expressed that if we had a separate category it should not exceed 25 per cent, as against variations that go to the point of 50 per cent of the capital gain being included in the ordinary income of the taxpayer and 50 per cent subject to a flat rate.

This is on the theory, presumably, that in the graduated rate of taxation individuals in the higher bracket would be subject to a higher tax.

Mr. Woods: If a capital gains tax is introduced, it should be at a separate rate and as low as possible.

The Acting Chairman: Would you consider 25 per cent as a ceiling?

Mr. Woods: We do, because of the capital gains tax in other countries. Twenty-five per cent seems to be the highest figure that we can logically use.

The Acting Chairman: In regard to intercorporate dividends, are you dealing with the exemption in respect of dividends from one Canadian company and another and dividends from corporations where the receiving corporate taxpayer has a 25 per cent interest or more, or are you suggesting complete exemption in respect of any intercorporate dividend income?

Mr. Sim: The present exemption for dividends flowing between all-Canadian corporations should be retained. As far as the flow of dividends from non-resident companies in which Canadian corporations may be interested, the exemptions should be retained at least for those companies where a degree of control is retained, a possible figure being 25 per cent.

The Acting Chairman: Which we now have.

Mr. Sim: Yes.

The Acting Chairman: So that we as a committee interpret the expression the exemption of intercorporate dividends—I should not have asked you that question, because you say “be retained”. You are dealing with the retention of the present system.

Mr. Sim: That is correct.

The Acting Chairman: With respect to depletion allowances this is a pretty puzzled committee, in so far as some senators are concerned as to how to handle depletion and tax holidays, particularly for the mining industry.

Did you listen to any suggestions or have you read any of the briefs or summaries where the suggestion was made that tax holidays and possibly depletion allowances should be of one character in relationship to existing mines, as distinguished from a different rate of depletion and a different approach with respect to tax holiday for the opening of new mines?

There is a subheading of new mines either in an area now urbanized in Canada or new mines that have the effect of pushing the frontier of Canada northward.

Mr. Kerr: By way of introduction I would like to emphasize that Trans Canada Pipelines' main business is the transmission of natural gas from west to east and the U.S. middle west market.

However, for the last three years we have had a wholly owned subsidiary, Banner Petroleum Limited, operating so far in Alberta. We have invested about \$9 million which, in the overall exploration and drilling picture in western Canada, is not really very great.

Exploration and drilling and hence depletion and depletion allowance are not major factors in our affairs. Our main interest as a company is to make sure that no changes in the tax rules are put into effect that will increase the cost of natural gas at the wellhead.

We are very concerned not only about remaining competitive, but in landing natural gas in the marketplace in eastern Canada at the lowest possible cost. That is the main goal of Trans Canada. If the depletion allowance changes created an upward adjustment of such costs we would not be very happy.

Mr. Woods: As Mr. Kerr said, we are essentially in the utility business. We heard some discussion today with regard to mines. We do not consider ourselves experts to deal with the subject.

Mr. Kerr: We are members of the Canadian Petroleum Association, who have dealt with this rather completely in their brief. We support their position.

Senator Cook: What do the witnesses have to say with respect to the reference in the White Paper to the effect that depreciation rates might be generous? I notice in your annual statement that you had depreciation of \$18 million last year, which is at the rate of 2 per cent on pipeline and $3\frac{1}{2}$ per cent on compressor stations. Do you think there is any room for depreciation allowances to be reduced?

Mr. Woods: It would be undesirable, sir. While the rates you have quoted are those we use for financial statement purposes, capital cost allowance, we can claim about 6 per cent. We consider this to be a great stimulus to companies to expand. Claiming these capital cost allowances allows us to defer payment of income taxes in the early years, which helps expansion and has been very successful to date. It would be unfortunate to have it changed.

Senator Cook: Do you think that a White Paper on Tax Reform is complete without the other side of the picture, the Government indicating their proposals with respect to depreciation rates?

Mr. Woods: No, I think it is an integral part of the whole program.

The Acting Chairman: The point that Senator Cook and the committee have been making from time to time is that it is very difficult to get a complete picture with respect to tax holidays, depletions, exploration and development expenses when we have a sort of casual reference in the White Paper to the effect that the whole subject matter of amortization or capital cost allowance will be the subject of further study and consideration.

We are left somewhat in the air in considering certain aspects of the White Paper when all we have is a statement of intent by the Crown to look into the subject matter. This creates uncertainty as to whether we are to receive benefits or experience reduction in the capital cost allowance rates.

Senator Cook: The indications are against benefits, Mr. Chairman. It says they are very generous.

Mr. Woods: We agree with the senator. It is very worrisome and goes against our whole projection of what the future will be.

The Acting Chairman: Do I summarize your feelings, as an important company, that the sooner this matter is dealt with by the Government the greater the chances are of setting at rest the existing uncertainty?

Mr. Kerr: We subscribe to that 100 per cent.

The Acting Chairman: I wanted to get that formulated. I think that covers the basic points that I have in mind. Are there any other matters to be raised? Do not worry about the time. We will stay with you. Are there any other matters that you would like to present?

Mr. Woods: I think the key thrust of our brief is the question of integration. We are concerned that if integration is adopted in the method suggested, to the extent that there is to be foreign investment in Canada and equities in Canada, it will tend to direct it to expanding companies such as Trans Canada, as compared to more mature companies. We think that Trans Canada is a company which is 90 odd per cent Canadian owned and we think any tax change which would tend to make the shares of Trans Canada more relatively attractive to foreigners is not a step forward.

The Acting Chairman: So basically the only tax change that you really would like to see would be the elimination of withholding taxes on funded interest debt.

Mr. Woods: That is the only change we would like to see. For the rest, we would like to say "as is".

Senator Molson: I notice that they have dealt with the expenses laid out to earn income, sometimes called business promotion expenses and at other times entertainment expenses. I do not think we need to dwell on that at all.

The Acting Chairman: I do not think so.

Senator Molson: I think we have covered that so fully in our hearings, and their views coincided with those of the majority.

The Acting Chairman: That is what I would have thought. In going through the various sections, I think we have struck the high points and particularly Mr. Woods' point that we are back down to the main thrust of integration and its elimination.

Mr. Kerr: That is right, sir.

Senator Molson: And that very good point about withholding taxes on foreign debt.

The Acting Chairman: I am glad that that has come back into play, because we thought it was of some interest. I am sure that our advisers will have correlated the evidence, but I am glad it is being repeated here.

Senator Cook: It is a question of the amount of complexities in those systems.

Senator Molson: Perhaps I should ask the hardy perennial again, but it has been expressed on more than one occasion, that if the White Paper were accepted and put into force . . .

Senator Beaubien: God forbid.

Senator Molson: . . . the problems it would create for, first of all, Government administration and, secondly, for the corporations to do their necessary calculations, record keeping and returns and, thirdly, for the individual to sit down and lick his pencil and try to prepare his form, would be such that in fact the White Paper actually is not workable—just for those reasons, quite apart from all that we have been discussing.

Mr. Woods: Apart from saying quickly that we agree with you, sir, I do not know what other opinions we have. We think the integration proposal has got defects in itself, but we think that, if nothing else, the complexities it adds should almost be enough to eliminate it. An individual taxpayer will be totally confused by the time dividends pass from one corporation to another and you get creditable tax and he is sitting down to figure out his tax return. It is just about going to be impossible.

Senator Molson: Perhaps the only good thing we can say about that, Mr. Chairman, is that it will obviously bring increased pressures and perhaps business to the legal profession and perhaps that of accountants.

The Acting Chairman: Thus far, the only good feature about the integration system, as

I see it, Senator Molson, is that with the exception of probably three or four taxpayers, there is an expression of unanimity against it. That seems to be the only thing about it.

If there are no further questions, we thank you very much, gentlemen, for being here today.

The committee adjourned.

APPENDIX "A"

The Canadian Bar Association

**Submission on Proposals for
Tax Reform**

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PART B

TAXATION OF PROFESSIONAL INCOME

APPENDIX

Introduction

The Canadian Bar Association's continuing interest in the subject of tax reform has been expressed in many forms; by its annual discussions on current tax problems with the Minister of Finance, in conjunction with the Canadian Institute of Chartered Accountants, by its submission to the Royal Commission on Taxation, by its analysis of certain areas of the Royal Commission's Report and now by this submission on the "Proposals for Tax Reform" contained in the White Paper of November 7th, 1969.

We are keenly conscious of the need for major tax reform in order to eliminate the undesirable features of the present system and we welcome the invitation of the Government and of Parliament to submit our views as to how this reform should be carried out. Since the Association represents lawyers of many shades of political opinion, we have tried to avoid, to as great an extent as possible, the expression of views on questions of broad social policy. However, while we have tried, in the main, to confine our remarks to questions of the internal consistency and workability of the tax proposals in the White Paper, we have expressed our views on the tax policy questions where we considered this was necessary in order to evaluate the proposals.

Our submission is in two parts; Part A sets out our views on the proposals in chapters 2 to 6 of the White Paper and Part B, which has already been submitted separately to the House of Commons Standing Committee on Finance, Trade and Economic Affairs, contains a critical evaluation of the proposals in paragraphs 5.46 and 5.47 of chapter 5 of the White Paper dealing with the taxation of professional men on an accrual basis of accounting, rather than on a cash basis. Although we have tried to give the latter question the same objective study as the rest of the White Paper, we have separated this portion of our submission from the rest, since this proposal raises problems peculiar to the legal profession.

Throughout this brief the reference numbers in brackets are to the paragraph numbers in the White Paper and the chapter references are to the chapters of the White Paper.

Summary

PART A.

The Individual and Family in Tax Reform (Chapter 2)

We are not satisfied with the White Paper's proposal to retain the existing system of personal exemptions, with increased dollar limits. We suggest that a tax credit system, such as the Royal Commission recommended, is distinctly preferable as a more flexible device for lessening the tax burden on individuals with small incomes. Indeed, in paragraph 2.18 of the White Paper, the Government admits that the additional exemption of \$500 per year for persons over 70 and for disabled persons is not the best way to assist the incapacitated or the elderly; a tax credit system, offering the same dollar tax benefit to all such taxpayers, irrespective of incomes, has obvious advantages over an exemption system, which gives lower dollar tax benefits to those with lower incomes, who need the benefit the most.

The White Paper frankly concedes that the Government has not yet devised a satisfactory system for taxing family incomes, particularly where the wife works. In fact, this problem has even been aggravated by the proposed increase in personal exemptions. The proposed child care allowance is a worthwhile improvement but it cannot entirely resolve this difficult problem. It may be that the solution to this problem involves a decision to stop forcing all married taxpayers into the same tax mould; we believe that a married couple should be given the right, at their option, to file a joint return, with a suitable family unit rate structure, if it will produce a more favourable tax result for them.

The White Paper has conceded that the inability of employees to deduct many of the legitimate expenses which they incur in order to earn their incomes constitutes a major inequity in the present law. In our view, however, the proposed 3% allowance for such expenses, with a maximum of \$150 per year, does almost nothing to correct this situation and it may even aggravate it. We also oppose the proposal to deny deduction of the costs of attending conventions, club fees and entertainment expenses; we consider that this proposal would discriminate most unfairly against self-employed persons and salesmen who must incur such expenses in order to earn their incomes. We believe that, if it is uniformly enforced, the existing law is amply sufficient to deal with abuses of "expense account living".

While tax rates are, in general, a matter of broad policy which is beyond the scope of this brief, we are concerned that the inclusion of capital gains in the tax base will result in virtually confiscatory taxation for those who realize gains in the first few years of the new tax system unless the top marginal rates of tax are reduced immediately, rather than gradually over a five-year period, as proposed in the White Paper.

While we are pleased that the Government has now acknowledged the need for a general income averaging system in order to avoid discrimination against tax-payers with fluctuating or irregular incomes, we believe that the averaging method proposed in the White Paper will give relief to only a few of those who need it and we have suggested methods of improving it.

We have also reviewed the proposals respecting pension plans and retirement savings plans and we have suggested alternative proposals which, in our view, would carry out the Government's policy more effectively and more fairly.

Capital Gains as Income (Chapter 3)

We have made a number of suggestions for improvement of the Government's proposal for taxation of capital gains. We have not commented on the question of whether or not capital gains should be taxed. We believe that if a taxpayer has purchased an asset which has declined in value before valuation day, he should under no circumstances be subject to tax on any capital gain until he has fully recovered his actual cost. We have also discussed some of the problems involved in valuing property on valuation day and we have recommended that taxpayers be offered a number of valuation formulae which they could use as alternatives to a formal valuation, with its attendant cost and uncertainty.

We believe that gains realized from the sale of a taxpayer's residence should be completely exempt from tax or that, if this recommendation cannot be accepted, all the financial costs incurred in connection with the acquisition and improvement of the residence should be deductible in computing the gain.

We regard the proposal to treat taxpayers who give up Canadian residence as having realized all their assets at their fair market value as unduly onerous and as likely to create grave problems of international double taxation for such taxpayers.

We consider that the proposal to treat gifts made during a taxpayer's lifetime as deemed realizations of the donated property is unnecessarily severe and we have suggested an alternative "roll-over" provision. We also recommend that consideration be given to substantially reducing gift and death taxes in order to deal with the economic and social problems resulting from the combined effect of capital gains and death taxes. Based upon our experience with business reorganizations, we have also offered some suggestions for modification of the proposals dealing with the treatment of capital gains and "roll-overs" in that area.

Corporations and their Shareholders (Chapter 4)

Since the proposals in this chapter are novel and extremely controversial, we have had great difficulty with them. However, we have reached the following conclusions:

(1) The right of a closely-held corporation to elect to be taxed as though it were a partnership is desirable. However, the White Paper proposals impose unnecessary restrictions on the right to make such an election, with the result that many such corporations will be unable to avail themselves of this opportunity. In addition, we are not satisfied that this election will deal satisfactorily with the problems involved in taxing groups of corporations and we advocate a system of consolidated tax returns for them, on an optional basis.

(2) The distinction between closely-held and widely-held corporations is, we believe, unsound in principle and unworkable in practice. It is incorrect to assume that widely-held corporations constitute a distinct class in this country which compete only with one another and which can therefore be subject to a special tax regime. Taxpayers will be pressed by tax considerations into shifting from one status to another and into structuring business arrangements to gain the favourable features of each. Restrictions will also be placed on the normal processes of selling the shares of a private company or converting a private company to a public company.

(3) The five-year revaluation rule for shares of widely-held corporations assumes that such shares are readily marketable, whereas in fact large blocks of shares in such corporations may in some circumstances be much less marketable than shares of closely-held corporations. The rule therefore cannot be applied without great hardship. In addition, it will penalize foreign companies which have made public offerings of some of the shares of their Canadian subsidiaries. In our view, this proposal should be abandoned.

(4) If the distinction between closely-held corporations and widely-held corporations is to be abandoned, two alternatives are available. The first would involve adoption of the Royal Commission's proposals for full integration of corporate and individual taxation and full taxation of all gains on the sale of shares. If this resulted initially in too great a loss of tax revenue in respect of dividend income, it could be introduced gradually. However, because of the unavailability of creditable tax on corporate earnings which have not borne tax, full integration would make shares of companies in the extractive industries, in international business and in rapidly-growing, capital-intensive companies considerably more attractive to foreign investors than to Canadians. As well there would also be complex technical problems arising from full integration which would be difficult to resolve.

The second alternative would be to have partial integration and partial taxation of share gains of all companies. This would, of course, violate the principle that income earned indirectly through a corporation should be taxed in substantially the same manner as income earned directly through a sole proprietorship or partnership. In addition, even if this alternative were adopted, many difficult technical problems would remain, for some of which we have offered solutions. Moreover, we see no overwhelming advantage in a system of partial integration as compared with the present, much simpler, dividend tax credit system and we have therefore suggested an alternative incorporating the present system, with modifications.

(5) The Minister of Finance has indicated his willingness to consider special forms of tax relief for "small businesses". We propose that the special low rate of corporate tax on the first \$35,000 of taxable income, be retained but in the form of a five-year deferral of payment of the additional tax otherwise payable rather than as an actual tax saving.

Business and Property Income (Chapter 5)

A number of important proposals are made in this chapter for changes in the methods of taxing business and property income. We approve the proposal to allow amortization for tax purposes of the costs of "nothings", a class of expenditures that are treated most unfairly under present law. However, we see no reason why goodwill should be treated in this manner and we recommend that goodwill gains and losses simply be recognized at the time of realization. We regard as unfair and discriminatory the special rules proposed regarding the deductibility of losses resulting from holding rental real estate and the proposal to require separate classes for capital allowance purposes for each rental building costing over \$50,000.

We express concern as to the absence of economic studies upon which to base a sound judgment of the criticism in the White Paper of the present system of tax incentives for the extractive industries and of the assertion in the White Paper that substantially the same economic results can be achieved with the new proposals. We have suggested a number of modifications in the White Paper proposals in this area, which would, we think, provide fairer and more effective incentives, without creating some of the difficulties which would result from implementation of the proposals in the form suggested in the White Paper.

In reviewing the White Paper proposals for taxation of trusts we found that they were basically defective, in that the high flat rate of tax proposed for income and capital gains accumulating in trusts would be wholly unrelated to the rates of tax payable by the beneficiaries for whom they are being accumulated. An obvious example would be an estate in which the annual income from property held by the trustees is payable to a widow during her lifetime and upon her death the capital is to be transferred to a charitable institution; in this case, any capital gains realized

by the estate will be taxed at a 51.2% or higher rate, even though they belong to an exempt organization and will eventually be paid over to it. As lawyers, we are concerned with and have special knowledge of trusts and estates and their problems. We therefore felt compelled to devise a new dual system for taxation of trusts which we consider merits serious consideration as an alternative to the White Paper proposals. It combines a simple but equitable treatment for relatively simple trusts with a more elaborate and sophisticated treatment of complex trusts.

Taxing International Income (Chapter 6)

Since the tax laws of different countries vary widely, the proper treatment of international income necessarily presents great difficulty. Subject to important provisos, we have accepted the White Paper proposal to restrict the existing tax exemption on dividends from foreign subsidiaries of Canadian companies to subsidiaries operating in countries with which Canada has tax conventions and to use a tax credit system for all other countries. However, we have pointed out the problem which this might create for developing countries with which we do not have tax conventions. We oppose introduction of the cumbersome and much criticized U.S. rules relating to "controlled foreign corporations", as we believe that stricter and more vigilant enforcement of existing laws dealing with intercorporate pricing and corporate residence will be sufficient to prevent the diversion to tax havens of income which would otherwise have been earned in Canada.

We believe that the proposal to tax non-residents on gains on sales of shares of closely-held Canadian corporations and on sales of 25% or more of the shares of widely-held Canadian corporations violates existing international understandings as to the jurisdiction which is entitled to tax such gains and that the proposal may lead to international double taxation. Moreover, such provisions could easily be avoided by the use of foreign holding companies and it seems likely that they might also be evaded by foreign taxpayers who refused to pay such taxes. In our view, the only solution to this problem lies in the renegotiation of tax conventions with our trading partners.

PART B.

Taxation of Professional Men and an Accrual Basis of Accounting

We oppose this proposal for the following reasons:

- (1) Although the White Paper suggests that taxing professional men on an accrual basis is necessary in order to ensure greater uniformity in the tax treatment of various classes of taxpayers, it is a fact that the cash basis, upon which most professional men presently report their incomes for tax purposes, is the normal rule under the Income Tax Act. The vast majority of Canadian taxpayers report their incomes on the cash basis and no suggestion has been made that this general rule should be changed.
- (2) The accrual basis, as normally understood by accountants, is not really a better measure of income for lawyers than the cash basis, in view of the great difficulty in determining the value of work in progress and the necessity for formal taxation of lawyers' bills by a court official before they can really be considered as creating accounts receivable.
- (3) The proposal has undesirable side effects, in aggravating the problem of finding cash for payment of tax, particularly among younger professional men, and in deterring lawyers from extending leniency to their clients in connection with the payment of their accounts.
- (4) While we doubt that there are any significant abuses in connection with the deferral of receipt of accounts receivable, we believe that, if any abuses can be shown to exist, suitable remedies can be found without requiring such a drastic step as a compulsory accrual basis for all professional men.

PART A

The Individual and Family in Tax Reform (Chapter 2)*Personal Exemptions (2.2-2.4)*

As a device to lessen the tax burden on lower income individuals, increasing personal exemptions seems to be highly questionable, since most of the benefits of increased exemptions are enjoyed by higher income individuals and, in fact, the higher the individual's income, the greater the dollar tax benefit derived from the exemption, although this effect may be somewhat offset by adjustment in rates. The Royal Commission dealt with this problem and recommended a tax credit system which would give the same dollar tax benefit to all individuals, irrespective of their incomes. We consider that the Commission's proposals in this area are distinctly preferable, as being a more efficient method of achieving the stated policy. The Department of Finance has recently argued that suitable changes made concurrently in both the exemptions and the rate schedule will produce the desired net results. Obviously, this is mathematically correct, but we submit that the retention of the exemption system will result in a less flexible system for future tax changes since it is hardly to be expected that the exemptions will be changed by Parliament every time the rate schedule is altered.

Family Unit (2.5)

We agree with the White Paper's rejection of a compulsory family tax unit consisting of husband, wife and minor children, as proposed by the Royal Commission. However, the problems of dealing with the incomes of husbands and wives, particularly where the wife works, have not been satisfactorily resolved by the White Paper. In fact, the working wife's problem has been aggravated by the proposal to increase the personal exemptions from \$1,000 to \$1,400, since it means that the first \$1,150 (\$1,400 minus the \$100 medical and \$150 employment allowances) of the wife's income is, in effect, taxed at her husband's marginal rate.

There also seems to be a distinct unfairness in subjecting a married couple whose incomes are unequal to a substantially higher amount of total taxes than if their incomes were equal. Since the White Paper indicates that this is a matter which will be reconsidered in depth, we suggest that consideration be given to the proposal which we made to the Minister of Finance in 1968 that a married couple should be given the option to elect to file a joint return with a suitable family unit rate structure if it will produce a more favourable tax result for them.

Child Care Expenses (2.7-2.9)

We approve of the general principle stated in these paragraphs. In our view, the present tax law discriminates most unfairly against working wives or female heads of households by denying a deduction for the expenses of child care. However, we question the desirability of setting arbitrary dollar limits on such expenses. For example, if a woman physician is able to earn substantial fees from her profession, she should, we think, be able to deduct the expenses of a housekeeper to look after her children, as long as she can prove that such expenses were necessary to earn her income. If arbitrary limits are to be set, however, the deductible amount of \$500 per child under the age of 14, or \$2,000 per family is insufficient as a top limit since these amounts are not realistic in relation to existing costs. In the event that it is decided to use arbitrary limits we submit that the limit should be expressed as a maximum dollar amount or not more than a specified percentage of the earned income of the parent with the lower earned income, whichever is the lesser.

Employment Expenses (2.10, 2.12-2.13)

As the White Paper states, the fact that the law does not permit a deduction for expenses incurred by an employee in earning wages or a salary, except for a few specific items, constitutes a long-standing grievance on the part of employees. However, in our view, the White Paper proposal does little to rectify this situation. Granting an arbitrary allowance for employment expenses of 3% of employment income, with a maximum of \$150 per year, without proof of payment of these expenses, constitutes discrimination against those employees who, in fact, have such expenses and against taxpayers who are not employees and who are not permitted such a standard deduction. In addition, certain classes of employees, for example, entertainers, teachers and mechanics, may frequently spend far more than \$150 per year for the purpose of earning their incomes. We consider that the only satisfactory principle is to allow all reasonable expenses of earning employment income, on proof of the expenditure and that it was laid out for that purpose. Certain items, such as the cost of travelling to and from work, might be specifically excepted from deduction, but we think that the general principles of income tax law, supplemented by the publication of information bulletins by the Department of National Revenue, should be sufficient to deal with any remaining problems.

Convention and Membership Expenses (2.11)

The expenses of conventions of professional, business or trade union organizations conducted for legitimate objects and purposes of such groups should be deductible. Such meetings procure benefits to the public as well as to the members of such organization. They are urgently required in an age of specialization where ideas, methods and procedures are constantly changing through research, advanced technology and development.

Club membership fees and expenses should be deductible where the prime purpose of such membership is a business purpose; if the purpose is not primarily a business purpose, then we suggest that the Minister of National Revenue should permit the deduction of that portion of the cost of the membership which can be attributed directly to the earning of business income. The administration of this proposal would be facilitated by placing the onus of proof on the taxpayer to establish the relationship between a club membership and the earning of business income. It should be realized that the provisions of the present Income Tax Act are more than adequate for the control and elimination of abuses where they occur. Entertainment expenses should be deductible if it can be shown by the taxpayer that he incurred such expenses in relation to business, actual or anticipated. The test of deductibility should, in our view, be the reasonableness of the relationship of the expense incurred and the income purported to be derived therefrom. Therefore, we suggest that all legitimate expenses of self-employed persons should continue to be permitted as deductions and we are in favour of extending this privilege to employees.

With respect to automobile and aircraft expenses, the proposals contained in the White Paper are not new, but merely reflect the existing tax situation as outlined in Information Bulletin 32, issued by the Minister of National Revenue.

Exemption for Taxpayers over 70 (2.18)

We do not consider that a \$500 tax exemption applying to all elderly people, regardless of income, is a proper method of providing benefits to the aged poor. A tax credit would be preferable if it is decided that the tax system should be used to provide such benefits. (This is an excellent example of the greater flexibility and equity resulting from the use of a tax credit system).

Additional Amounts to be Included in Income (2.21:2.27)

We agree with the principle proposed for the treatment of unemployment insurance, namely, deductibility of contributions and taxability of benefits. We also believe that this principle should be applied to all similar situations.

Tax Rates (2.28-2.44)

We believe that the top marginal rates of personal income tax on the expanded tax base should be reduced immediately in order to ease the transition to the new system and to avoid taxation of capital gains realized in the early years of the new system at nearly confiscatory rates. The revenue considerations are admittedly minor and the gradual reduction of rates over a five-year period will be unfair and will encourage schemes of artificial income deferral. In addition, if dividend distributions have to be made within a $2\frac{1}{2}$ year period, in order to qualify for integration, as stated in paragraphs 4.27 and 4.37, it will be particularly onerous for shareholders who are temporarily in very high tax brackets.

Pension Plans and Retirement Savings Plans (2.45-2.52)

While there may be theoretical reasons for setting limits on contributions to pension plans and retirement savings plans on the basis of the level of benefits ultimately to be derived from such plans, it seems to us that there are almost insurmountable difficulties in implementing such a principle. We therefore consider that annual limits on the deduction of contributions to plans should be continued. However, to the extent that an individual failed or was unable to take advantage of the right to make a payment into a plan in earlier years, a carry-over of the unused deduction should be permitted in order to enable him to make a larger deduction in a subsequent year. In the case of registered retirement savings plans, this carry-over should be permitted from the commencement of the new system. In the case of registered employee pension plans, this is covered by a system of approved past service contributions. We believe that the proper basis for approving past service contributions should be to permit deduction of a sum equivalent to the contributions which could have been made since the commencement of the employee's service, together with interest at an appropriate rate. The present practice of calculating lump sum past service contributions by reference to the level of anticipated pension benefits seems to us to be unsound in principle and to create undue discrimination in favour of executive pension schemes, which has aggravated problems of administration and taxpayer co-operation.

We should also like to point out the very serious administrative problem which has arisen in connection with the application for registration of so-called "shareholder pension plans". It seems to us quite reasonable, in principle, for the Department of National Revenue to deny registration to pension plans which discriminate in favour of shareholders of the employer, as shareholders. However, where the shareholders are in fact the major executives of the employer and where the proposed plan treats them on a parity with other employees who are not shareholders, we see no reason why registration should be denied. Even in a company in which the only employees are also shareholders, approval of the plan, should, we think, be given as a matter of course as long as the pension contributions and benefits are in line with those prevailing in other plans. That is, the principle must be affirmed that, unless a plan discriminates in favour of shareholders, as shareholders, it should be approved for registration.

We think that the major problems in connection with allegedly discriminatory pension plans would be greatly alleviated if our suggested basis for computing lump

sum past service contributions were adopted. It is essential in this area that there be substantial certainty concerning the eligibility of a given plan for registration, and the deductibility of contributions to it. The administration of pension plans and registered retirement savings plans would be greatly facilitated if definite rules were enunciated and published. It is particularly unsettling at the present time to find that pension plan arrangements which have proceeded for a number of years have been called into question by the Department of National Revenue and assessments issued for large tax deficiencies.

At the present time, a pension plan must have 90% of its income from Canadian sources in order to obtain tax exemption. The White Paper proposes that this restriction be amended in order to require that 90% of the assets of the plan be invested in Canada. While we make no comment on this principle, it is important to provide an adequate transitional period in order to avoid unnecessary hardship upon the beneficiaries of plans which must make major changes in their portfolios.

Under the present provisions of The Income Tax Act and Regulations, and particularly Section 36 of the Act, lump sum payments withdrawn from pension funds or registered retirement savings plans are eligible for a special averaging provision. The White Paper proposes that this averaging provision be removed completely, except for the new general averaging provisions available to any taxpayer under the new system, and a deduction to be granted to a widow upon her contributing all or part of the benefits received from her husband's pension or retirement plan to her own registered retirement savings plan.

This proposal appears to be unfair on three grounds:

(1) Since it is not unusual for a man to leave dependents alive other than a widow, there appears to be no logical reason why a dependent of a husband, other than a widow, should not have the same right of investing money in his own registered retirement savings plan.

(2) Persons who are facing retirement in the next five years and who have been calculating their pension benefits based on the availability of the present averaging provision will now find their pension benefits substantially reduced. Unfortunately, this gives the proposal an undesirable retroactive effect. Special provisions will have to be made to deal with the situation where persons have their pension contributions already locked into an existing pension plan or retirement savings plan.

(3) Unless pension benefits are withdrawn substantially on a lump sum basis, the benefit of the averaging provision will be totally lost. Unfortunately, the averaging provisions proposed by the White Paper do not afford much relief, if any, until a large increase occurs in the taxable income of a taxpayer. Improvement of the general averaging provisions, along the lines suggested in this brief, would do much to resolve the problem.

Paragraph 2.52 of the White Paper states:

"Rules are required to ensure that the trustees of a pension or retirement plan fund are liable and responsible for paying taxes arising out of its operations. This would be necessary if, for example, beneficiaries leave Canada with the assets."

This proposal seems to involve a misunderstanding of the function and responsibility of trustees. It is quite proper to require trustees to deduct and remit withholding tax on monies which they pay to a beneficiary and if they fail to do so, they ought to be personally liable for these taxes. In addition, if either knowingly or through

negligence they permit a beneficiary to abscond with assets of the pension plan they ought also to be personally liable for the taxes which should have been paid. We find completely abhorrent, however, the suggestion contained in the White Paper that a trustee should be under any absolute liability for these taxes in the absence of negligence or wilful default. If, for example, a beneficiary were to steal the assets of the pension plan, it would be grossly unfair and contrary to our traditions in this country to require the trustee to pay the taxes for which the beneficiary may be liable.

General Income Averaging Option (2.53-2.59)

We are encouraged by the Government's acceptance of the principle that general tax relief must be given to individuals who are in receipt of irregular or fluctuating incomes. Many systems of income averaging or quasi-averaging are possible for providing such relief. The method proposed in the White Paper, if effective at all, seems to provide relief only in cases of extreme hardship. The proposal to set a "threshold" of $133\frac{1}{3}\%$ of the average income of the previous 4 years and to deny any relief to taxpayers except in respect of income earned over that threshold seems to us less than generous, or, indeed, adequate. Since we understand that these tax calculations can readily be made on a computer, we see no reason why the "threshold" should be any higher than 100% of the average income of the previous 4 years.

One of the difficulties of using the quasi-averaging technique espoused in paragraph 2.56 is that, while it provides tax relief in a year in which a taxpayer's income is unusually high, it does not provide a tax refund in a year in which his income is unusually low, when a tax refund would be most helpful. The averaging technique for farmers and fishermen in Section 42 of The Income Tax Act seems preferable in this respect.

CAPITAL GAINS AS INCOME (Chapter 3)

Introduction (3.1-3.12)

Our comments are based upon the assumption that some form of tax on capital gains will be introduced. We make no comment on the economic and social issue of whether capital gains should be taxed and, if so, at what rates.

We believe there is a classification which would not be included in either a capital or an income gain which is often referred to as a "windfall" gain. If capital gains are to be taxed, we cannot understand the exclusion of windfall gains merely because they are fortuitous.

Paragraph 3.10 of the White Paper comments upon the tendency over the years of taxpayers to convert income into some form of capital gains, i.e. "surplus-stripping". We believe that the surplus stripping problems have been substantially eliminated.

Paragraph 3.12 comments upon the distinction between what is a capital gain and what is income and refers to the owner's original intention as the most important test. We believe that a similar type of distinction will develop as a problem in the event that the distinction between widely-held corporations and closely-held corporations is adopted. The distinction between income and capital gains would also continue to be important in the event that there is a different rate of tax on capital gains.

The Proposal (3.13-3.18)

Paragraph 3.15 states that:

"... the general rule would be that taxpayers could deduct from the proceeds of sale of assets the value of those assets on "valuation day"."

Paragraph 3.15 contains an example of the application of the proposed system with respect to the purchase and sale of a block of shares. The example assumes that their value on valuation day will exceed the original purchase price. The example fails to consider the situation where the value on valuation day is less than the original purchase price. For example, where shares have a purchase price of \$1,500 and a value on valuation day of \$1,200 and are later sold for \$1,400, there is an actual loss of \$100 but, under the proposed system there would be an assumed profit of \$200. If the shares are sold for \$1,600, there would be an actual profit of \$100 but under the proposed system there would be a paper profit of \$400. It is recommended that no tax in fact be levied until a taxpayer has recovered his actual cost. The logical corollary of this proposal is that only actual losses should be allowed. However, in the interests of protecting the revenue yield from the tax, it is recommended that only losses to be recognized will be in respect to sales at prices less than V-Day value. We, therefore, agree with the "general rule" referred to in paragraph 3.15 subject to the qualification that under no circumstances will tax be levied until a taxpayer has recovered his actual cost. This qualification is consistent with the Minister's post White Paper statement concerning bonds and mortgages.

As an alternative to an actual valuation and for the purpose of minimizing the cost to the taxpayer and the administrative burden to the Department of National Revenue, we recommend that taxpayers be given the right to elect to be taxed on either the profit, measured by the difference between the sale price and V-Day valuation, or that amount of the difference between the sale price and the historical cost

which bears the same ratio that the time during which the property was held after valuation day bears to the total time that the property is held by the taxpayer. For example, if an asset has been held for ten years and is sold at the end of the first year of the new system, the taxable profit would be 1/10th of the difference between the sale price and actual cost. This alternative is similar to the one recommended by the Royal Commission on Taxation.

This is only one of several “safe havens” we think should be provided. As many safe havens as possible should be provided, subject always to the right of the taxpayer to have his gain or loss determined on the basis of an actual valuation. Furthermore, a taxpayer should be given the right to submit a valuation within, say, two years of valuation day and such valuation should be deemed forever valid as against the Department of National Revenue unless the Department challenges it within, say, two years of the filing of the valuation with the Department.

Paragraph 3.17 of the White Paper states that the averaging provisions described in Chapter 2 will protect a taxpayer from “a marginal rate of tax considerably higher than the rate that would have applied had his income been spread over the years during which a gain accrued”. We believe the averaging provisions to be less than generous. The reasons for this conclusion are contained in the comments under Chapter 2.

With further reference to paragraph 3.17 of the White Paper, as mentioned in our comments under Chapter 2, we recommend that the 50% rate be implemented at the beginning of the new system and not over a period of five years as is presently proposed.

Principal Residences (3.19-3.21)

The concept of taxing capital gains on the sale of a principal residence is equitable in our view only if:

(a) There is a continuous roll-over to the extent that the sale proceeds are used within a reasonable time to purchase another principal residence including a self-owned apartment or a condominium;

(b) such reasonable time limitation includes safeguards for situations such as a person on a leave of absence from his employment, a person who is posted abroad for a period of time, etc;

(c) the proposed allowance of (at least) \$1,000 per year of occupancy plus improvements is part of the system;

(d) there is an exemption in the case of a sale or a gift of a principal residence to a spouse or child (the donor's or vendor's original cost base plus the \$1,000 per year factor, plus the greater of \$150 per year or the cost of actual improvements to the time of disposition would represent the cost base to the donee or purchaser);

(e) a capital loss will be recognized, the cost basis for ascertaining such loss to be the value on valuation day plus some improvement factor or the capital cost of improvements made between valuation day and disposition (but not including the \$1,000 per year occupancy allowance.);

(f) interest paid on financing the purchase of a principal residence forms part of the cost basis pro rata to the ratio that the cost bears to the selling price.

(g) municipal taxes attributable to local improvements are recognized in full as part of the cost basis; and

(h) insurance premiums relating to the principal residence form part of the cost basis.

Alternative Proposal Re Principal Residences (3.12-3.21)

The Minister of Finance has on several occasions emphasized that it is not intended to levy a tax on the disposition of homes. Because of this and because of the foregoing proposals with all of the adjustments inherent in them which are required in order to make a system of taxing homes equitable, it is recommended that gains on the sale of a principal residence be completely exempted from taxation.¹ The term "principal residence" should be defined having regard to the land area and size of the building and their aggregate value so that gains on unreasonably large properties would be taxed.

Other Property Held for Personal Use or Enjoyment (3.22-3.27)

We submit that the taxation of capital gains made on the disposal of property held for personal use or enjoyment is workable only if:

(a) there is a realistic allowance of say \$5,000 (and not \$500 as proposed in paragraphs 3.23 and 3.24 of the White Paper) to avoid nuisance situations and complexity in administration and so that genuine hobby situations undertaken for personal pleasure will not be taxed. (A \$5,000 allowance should help reduce the problem of the "set" referred to in paragraph 3.23):

(b) interest costs and insurance premiums form part of the cost base as recommended for a principal residence; and

(c) costs which in fact relate to the preservation of the value of the assets are recognized in full as part of the cost basis of the asset.

Shares of Closely-Held Corporations and of Widely-Held Canadian Corporations (3.31-3.38)

Our comments and recommendations concerning the proposed treatment of such shares are included in our comments under Chapter 4, "Corporations and their Shareholders".

Deemed Realizations (3.39-3.40)

There are two situations proposed which will result in gains being taxed even though a taxpayer has not disposed of property. One situation is the "five year rule" which we deal with in our comments under Chapter 4. The other situation is referred to in paragraph 3.40 and "would occur when a taxpayer gives up Canadian residence". We believe that this proposal requires further study because in our judgment such a provision would be impractical to enforce. It also has other important implications. For example, such a proposal stands alone and is unlike any treatment of capital gains in the United Kingdom and the United States. If this proposal for a "departure tax" is implemented it could place a Canadian in the invidious position of being taxed on a deemed realization on moving to the United States and on being taxed a second time in the United States on an actual realization without any offsetting tax credit.

We think it is better to sacrifice some neutrality and equity in favour of a tax system which conforms substantially with the tax systems of other nations.

If this "departure tax" proposal is to be implemented there should be some roll-over relief granted to a non-resident who declares that he is entering Canada for a temporary purpose and to a resident of Canada who declares that he is leaving

1. The United Kingdom exempts principal residences from capital gains tax.

for a temporary purpose. There should also be complete exemption where a taxpayer emigrates to a country with which Canada has a tax treaty. In any event, as previously stated, there should be further study of this important proposal.

Gifts and Bequests (3.41 and 3.42)

We have the following comments on the White Paper proposals relating to gifts and bequests:—

(a) It appears that it is intended that the donor of a gift is to be subject at the time of the gift not only to gift tax but also to a capital gains tax.

(b) The White Paper does not specify that the gift tax will be added to the cost base of the donor in ascertaining his capital gain as is recommended in the White Paper for bequests.

(c) The imposition of a capital gains tax with respect to a gift to the spouse of the donor appears to be contrary to the spirit and intent of the present policy of the Government as reflected in the 1968-69 amendments to the Income Tax Act exempting gifts to spouses from gift tax.

We recommend that:—

(a) A capital gain should not be accrued at the time of a gift made to anyone but should be deferred in a manner similar to the deferral or roll-over in the case of bequests on death proposed in the White Paper. If this recommendation is accepted, any gift tax paid by the donor should be added to the donee's cost base in determining his capital gain in the same way that death taxes are added to the cost base of a beneficiary. Such gift tax represents a cost of making the gift in the same way that death taxes represent the cost of inheriting property.

(b) If there is to be no deferral granted as we suggest then:

- (i) there should at least be a deferral of capital gains tax in the special situation of a gift to one's spouse;
- (ii) in cases where there is no deferral, any gift tax should be added to the cost base of the donor in measuring his capital gain; and
- (iii) transfers of property taking place in matrimonial disputes should not only continue to be exempt from gift tax but also from any capital gains tax and the recipient of the property should take the transferor's cost base as at the time of the transfer.

(c) It is not clear whether the cost base as assumed by beneficiaries of an estate is intended to take into account provincial succession duties and it is recommended that such duties form part of such cost base.

No reference is made in paragraphs 3.41 and 3.42 of the White Paper to charitable gifts. It is assumed that such gifts (like any other bequest) would not be subject to a capital gains tax on death. However paragraph 3.41 of the White Paper seems to suggest that a charitable gift inter vivos is not to be exempt from capital gains tax. This we think requires further study. It is important, in our opinion, not to create tax laws which will inhibit the making of inter vivos charitable gifts.

We recommend that consideration should be given to substantially reducing gift and death taxes in order to deal with the economic and social problems resulting from the combined effect of capital gains and death taxes. In this connection, one possible feature of a revised capital gains tax proposal might be deemed realization at death provided that this was accompanied by substantial reductions in gift and death taxes. This might also facilitate a wider range of roll-overs during a taxpayer's lifetime while eliminating the "lock-in" effect of the proposed roll-over on death accompanied by the stepped-up cost base (as used in the United States).

Roll-Overs (3.43-3.52)

The White Paper notes two types of situations in which it would be “unfair” to tax a capital gain on disposition. The first type is where there has been a forced realization and we make no comment on the proposals relating thereto. The second type is where there has been no significant change of underlying ownership as in a re-organization.

With respect to the second type of situation, the White Paper specifically proposes that a roll-over be permitted in the following cases:

- (a) where a person transfers assets to a corporation in which he owns all of the shares (3.45-3.47);
- (b) where a partnership’s assets are transferred to a newly incorporated company (3.48);
- (c) on the winding up of a closely-held Canadian corporation (3.49);
- (d) on a simple share split (3.50); and
- (e) on a “take-over” involving shares of a widely-held corporation (3.52).

The paragraphs dealing with roll-overs on corporate reorganizations are imprecise. There are qualified generalizations which leave one wondering what is to be excluded and what is to be included in the “mosts”, the “almost always”.

The expressed basis for exempting these transactions is that to tax them would be “unfair”. The unfairness is apparent in a situation where a realization is forced upon the taxpayer. However, in the case of corporate reorganizations, we submit that it is more tax neutrality that should be aimed for rather than the avoidance of unfairness. Decisions with respect to whether to incorporate, wind-up or amalgamate or as to the appropriate entity to carry on a transaction or a business should ideally be made on the basis that tax implications would be the same no matter what the decision. This seems to be supported in paragraph 3.51 where it is stated that it may be possible later to identify more situations in which a roll-over may be granted without permitting taxpayers to accomplish tax-free in an indirect manner what would be taxable if done directly. We consider it more equitable to initiate a broader tax-free roll-over system and in due course to impose restrictions by legislation if abuses become apparent from experience.

The White Paper says that the “second type of transaction” which would qualify for a roll-over, that is the type where there has been no change in underlying ownership, which “would almost always involve a corporation”. In all the stated cases, a corporation is involved. Does “almost” mean that there are to be other roll-overs permitted in cases where there is no change in underlying ownership, but where no corporation is involved, such as transfers to partnerships, transfers in trust, or transfers between trustees where the beneficiary is the same?

Clarification is required for the following situations:

- (a) transfers between corporations both of which are owned by the same shareholder or both of which are owned by the same group of shareholders in the same proportions;
- (b) transfers between corporations within a group¹;
- (c) the treatment of any capital loss in the computation of tax in situations where a gain would not be deemed to be realized;

1. We understand that in the United Kingdom, assets transferred between corporations in a group of corporations all of which are 75% beneficially owned by the same shareholders are not taxable.

- (d) the tax basis of a bonus issue of shares or a rights issue;
- (e) the basis of taxation of convertible bonds;
- (f) whether bonds that are called for redemption are to be given the tax benefit of a forced realization with a one year roll-over or whether a gain is taxed immediately;
- (g) the treatment of redeemable preference shares e.g. redemption in cash or by the issuance of new shares or a debenture to the same shareholder¹; and
- (h) reduction of capital.

If the White Paper lists only those transactions which are to be non-taxable then it is our view that the list is much too severely limited both from the point of view of fairness and the point of view of erecting tax barriers to economically advantageous reorganizations.

Roll-Overs — Specific Proposals Made in the White Paper and Comments Thereon

Under this heading we have tried to outline the White Paper proposals for roll-overs, indicate the restrictions which would apply and give our comments.

Proposal 1 (3.45-3.47)

Where a person transfers some of his assets to a corporation in which he owns all of the shares, the transaction will be treated as if it was a sale at the cost to the taxpayer of the property transferred. Tax would be postponed until the corporation sells the asset or the individual sells his shares.

Restrictions:

- (a) No roll-over on transfers to foreign corporations. (This would result in tax-free gains).
- (b) No roll-over on transfers to widely-held Canadian corporations. (Because of the half gains rule, and because the provisions would become too complex).
- (c) No roll-over on transfers of shares of widely-held Canadian corporations. (Provisions too complex, and this would lead to postponement of 5 year revaluations).

Proposal 2 (3.48)

When partners incorporate a company and transfer the partnership assets to the company in exchange for shares, the transaction will be treated as a sale by each partner to the corporation of his interest in the assets at the cost to the partner of his interest, provided that the shareholders in the new company have the same economic interests as they had when they were partners.

Restrictions:

Presumably the same restrictions would apply with regard to Proposal 2 as with regard to Proposal 1.

Comments on Proposals 1 and 2:

(a) It is not clear why the roll-over will not be permitted on transfers to widely-held corporations² if the rollover is to be restricted to cases where the transferor is the sole shareholder of the company.

1. In the case of the issuance of new shares or debentures, it is our understanding that the United Kingdom permits a roll-over.
2. Under the White Paper proposals all of the shares of a widely-held corporation could become owned by one shareholder without changing the company's status as "widely-held".

(b) The Royal Commission recommended that transfers to a corporation that had more than one shareholder would be free of tax provided the transfers are in proportion to the shareholdings. This seems consistent with the general policy expressed in the White Paper on this point though no specific mention is made of cases where there is more than one shareholder.

Proposal 3 (3.49)

On the winding up of a closely-held Canadian corporation the tax treatment would be as if there had been a sale of the assets to the shareholders at a price equal to the cost basis to the shareholders of their shares, followed by a distribution of the proceeds of sale on the liquidation of the corporation, provided that there is only one shareholder or, if several, that their economic interests are the same after the liquidation as before.

Comment on Proposal 3:

We believe that this proposal requires further study and analysis to ensure that it is workable and fair.

Proposal 4 (3.50)

If there is a simple share split with no increase in paid-up capital, the split would not attract tax and each shareholder would spread his cost of the old shares over the new shares.

If all the shareholders receive something different in quality as well as different in number than they had before, then they will be taxed on the gain they derive to the extent of the value of the new asset that they have received.

If some of the shareholders of one class receive something different from other shareholders of the same class then the transaction would be taxable.

Comments on Proposal 4:

This is a difficult area. We suggest that it is not necessary to tax share splits, e.g. warrants, bonus shares, immediately. We think that the preferable alternative is to adjust the cost base of the existing shares.

Proposal 5 (3.51)

It is proposed to treat "most reorganizations which involve only the shares of widely-held Canadian corporations as non-taxable transactions". All other reorganizations will be regarded as taxable realization, until such time as it can be demonstrated that any particular form of reorganization could take place without loss of tax revenue.

Comments on Proposal 5:

(a) It is not clear what is meant by "most" and it is useless to speculate since there is no clue as to what may be exceptions.

(b) This exemption is granted only because of the 5 year revaluation and the 5 year revaluation is thus said to remove the tax barrier that would otherwise have impeded transactions that are otherwise desirable for economic reasons.

(c) "Most other reorganizations or mergers involve a change in economic interest". These must be taxed, "at least initially". "It may still be possible later to identify more situations in which a roll-over may be granted without permitting taxpayers to accomplish tax-free in an indirect manner what would be taxable if done directly". It seems that the Government proposes to start with a very narrow range of exemptions and leave the proponents of specific mergers or types of mergers to put

forward arguments for changing the law by establishing a continuity of economic interest and also no loss of tax revenue from granting a roll-over. It appears that avoidance of loss of revenue rather than avoidance of unfairness has become the test.

As previously stated we advocate establishing initially a broader tax-free system and in due course imposing restrictions by legislation as abuses become apparent from experience. To this we would add a recommendation for a system of quick rulings so that important business transactions will not be unduly delayed.

(d) Statutory amalgamations are not discussed and therefore we assume that no roll-over is intended. It appears that the Government intends to impose in this case a tax barrier which might impede transactions that are desirable for economic reasons.

(e) The amalgamation of Canadian subsidiaries of two foreign parents that have amalgamated could not take place without tax consequences and might thereby be prevented from taking place under the White Paper proposals.

(f) The proposals could hinder the amalgamation of smaller closely-held corporations to produce a larger economic unit that would have the capacity to go public and become widely-held. This type of growth will be impeded by the proposed system.

Beginning the System (3.53 and 3.54)

We agree with the comment and proposal contained in paragraph 3.53 of the White Paper.

With reference to paragraph 3.54, we agree that the Act should be drawn up in such a way as to make it clear that a taxpayer is still liable for tax on recaptured depreciation. However, we do not agree with the proposal contained in paragraph 4.79 of the White Paper which appears to have the effect of taxing recapturable depreciation claimed under the present tax system even though the property has not been disposed of and may never be disposed of in a transaction giving rise to recaptured depreciation. This proposal is unfair and is certainly contrary to the general principle stated in paragraph 3.39 of the White Paper that "the general rule would be that capital gains and losses would be taken into account for tax purposes in the year in which the taxpayer disposes of the asset". Recapturable depreciation should receive no different treatment. We note that recapturable depreciation does not fall within any of the exceptions to the "realization" rule set out in paragraph 3.39 of the White Paper. We recommend that pre-system recapturable depreciation be taxed only upon realization. This can be accomplished by valuing the asset on valuation day at its fair market value less the amount of recapturable depreciation, the difference representing the cost base of the particular asset.

Our comments concerning recapturable depreciation also extended to what we understand is to be the proposed treatment of goodwill. It is our understanding that a system similar to pre-system recapturable depreciation will be applied to goodwill in existence on valuation day. We firmly believe that the proposed system constitutes not only taxation imposed upon an unrealized gain but also constitutes retroactive taxation. We strongly oppose this proposal. Elsewhere in this submission we make our recommendations concerning what we consider to be an appropriate treatment of goodwill.

General Comment — Year of Liability for a Tax on Capital Gains

The system of reserves as permitted under Section 85B of the Income Tax Act for ordinary income should be extended to capital gains where some or all of the proceeds are payable over a period of time.

Corporations and their Shareholders (Chapter 4)

Closely-held and Widely-held Corporations and their Shareholders

The distinction drawn in the White Paper between "closely-held" and "widely-held" companies will inevitably create pressure to convert from one status to the other. Notwithstanding the comments in the White Paper that once a company is a widely-held company it will always have that status, we believe that ways would be found and pressures created to transfer the business of a widely-held company to a closely-held company. This might be accomplished by the creation of a new company and the sale of the assets to it. The conversion from a closely-held company to a widely-held company can, of course, be accomplished by "going public".

We believe that the distinction between widely-held companies and closely-held companies should be reconsidered. We are of the opinion that such a distinction will create inequitable results between different classes of investors particularly those who are only able to invest in widely-held companies. While the White Paper proposal to remove the dual rates of corporate tax will remove some inequities that presently exist in this area, we are strongly of the view that the creation of a new distinction, based upon the closely-held, widely-held concept, will create an entirely new and undesirable set of problems. This would be a most undesirable result.

If the proposed tax distinction between closely and widely-held companies is adopted, we are concerned that the historic growth from proprietorship to private company to public company may be affected. Many individual or family-owned corporations in need of capital have "gone public", that is, sold part of their shares and further treasury shares to the public in order to furnish the company with capital as well as to provide liquidity to the family to meet cash requirements such as death taxes. We believe it would be undesirable to interfere with such a process.

The tax cost to the shareholders of converting a private company to a public company in which the family retain a shareholder interest may prohibit and will, in our view, at least inhibit, such a transition. While all the earnings of the private company could be received by the family without tax cost under the White Paper proposals, the share of earnings retained by the family in a public company would receive less favourable tax treatment due to the distinction between closely and widely-held companies. The historic development from private to public company would tend to be reversed. That this is already happening as a result of the White Paper proposals is confirmed by members of this Association. Our information indicates that since the introduction of the White Paper the closely-held, widely-held concept has been a significant factor in deciding whether to go public. Further, sometimes the alternative is to sell out to another company which is often foreign-controlled.

The obligation of shareholders of widely-held Canadian companies to revalue their shares every five years and pay tax on any gain or loss is, in our opinion, unjustifiably onerous. There are a substantial number of shareholders of widely-held Canadian companies who are precluded by the respective securities laws of both Canada and the United States from readily marketing their shares. In fact, control blocks of shares in widely-held Canadian companies may, in some circumstances, be far less marketable than shares of closely-held companies. The proposal to revalue every five years seems to depend in part upon the marketability of the property. If this theory is fallacious in so far as a number of shareholders is concerned, then, in our view, it should be abandoned for all. In addition, it is anticipated that any re-negotiation of the Canada-U.S. tax convention to give effect to the proposal would meet with substantial resistance on the part of the United States. The elimination of the proposal would avoid this confrontation.

Other problems will undoubtedly arise if the distinction between closely-held and widely-held companies is maintained. Some of these problems are as follows:

(a) In the event that a closely-held company realized a gain on the shares of a widely-held company the tax payable by the closely-held corporation would be 25% of the gain. The distribution to the shareholder of the closely-held company, however, would be required to be included in his income to the extent of the whole gain and credit would be given for only 25% of the gain. As a consequence, the shareholder would pay tax as though the gain had arisen from the sale of the shares of a closely-held company. This is in marked contrast to the principle stated in the White Paper that income (including capital gains) realized through a closely-held company should be taxed to substantially the same degree as income earned by a sole proprietorship or a partnership.

(b) If the shares of widely-held Canadian companies owned by a widely-held Canadian company must be revalued every five years, complex rules would have to be established to avoid the pyramiding effect on the shareholders of the holding company.

(c) The five year revaluation may encourage Canadians to invest in non-Canadian companies and it will discourage offerings of shares of Canadian closely-held companies to Canadian residents.

Furthermore, the distinction in tax treatment between closely and widely-held companies would give a substantial advantage to the wealthy entrepreneur or a closely-held company in the acquisition of businesses. The price obtainable for the shares of a private company or for its assets is largely determined by its earnings. If the earnings of a business can be distributed without tax consequences to one purchaser (by reason of such purchaser obtaining full tax credit) but will be taxed in the hands of another, obviously the one purchaser is in a much more favourable negotiating position. The cumulative advantage available to the wealthy entrepreneur and the restraints against "going public" could tend to result in the accumulation of wealth in the hands of a small number of individuals unless, of course, the definition of a widely-held company included a company or related group of companies whose annual earnings exceeded a specified amount, which would, in turn, create new problems.

If the proposed distinction between widely-held and closely-held corporations is abolished there appear to be two major policy alternatives, namely, either full integration or some form of relief for double taxation either in the form of partial integration (as was proposed for the widely-held company perhaps also with credit for taxes spared or certain types of taxes spared to the Company because of governmental incentive etc.) or in the form of a revised dividend tax credit.

Full Integration

Among the problems which would have to be carefully considered if the concept of full integration is adopted for all Canadian corporations are the following:

(a) There could be an adverse revenue impact which may make it impractical. An alternative approach might be for the government to accept the principle of full integration for all corporations but implement such principle over a period of time as revenue flows permit.

(b) Full integration, and to a lesser extent partial integration, would make the mature Canadian company¹ a more favourable investment for the Canadian investor. Various tax incentives at the corporate level such as capital cost allowances,

1. Other than companies in the extractive or utility industries.

depletion, tax holidays, and direct write-offs of capital acquisitions would be taxed away at the shareholder level because of the lack of creditable tax. On the other hand for the non-resident investor, who would obtain no advantage from creditable tax, the extractive industry company and the less mature but fast growing company would be more desirable investments since they would tend to sell at a lower price because of their tax disadvantages to the Canadian investor. At a time when there is apparently great concern about non-residents acquiring a greater and greater proportion of Canadian industry and natural resources this might be a very serious drawback to integration and even to partial integration. In this connection we observe that it is somewhat ironic that the integration system, which is supposed to treat the corporation as a partnership, should have this result.¹

(c) Full integration and to a lesser extent partial integration would tend to place the Canadian international company at a disadvantage in relation to the Canadian company doing business at home since the free flow back of earnings, at least from treaty countries, would mean that such earnings, except for the proposed "flow-through" privilege for foreign withholding tax, when distributed to shareholders would not carry creditable tax. This may discourage Canadian companies from developing foreign markets and Canadian companies with substantial foreign incomes could be less attractive to Canadian shareholders, and possibly more attractive to foreign investors.

(d) the non-resident shareholder of a Canadian corporation would not be entitled to any benefit from the gross-up and credit mechanism of integration unless and to the extent such benefit results from treaty negotiations. We observe that this could result in trading in shares carrying creditable tax on arbitrage markets since the shares would be more valuable to Canadian residents, particularly just prior to dividend payment dates.

1. Unless the shareholders of the corporation are entitled to make the partnership election in which event the foreign tax would presumably flow through to the shareholder level, although the White Paper does not make this clear. In such circumstances, a closely-held corporation which could not elect to be taxed as a partnership would be penalized relative to one which could.

Dividend Tax Credit

If the government decides that the gross-up and credit mechanism of integration for corporate taxes paid has to be reconsidered, then one is inevitably driven to consider a different form of integration¹ that permits the benefit of tax incentives realized at the corporate level to flow through to the shareholders. In principle, a 25% dividend tax credit is not dissimilar to the 50% integration proposal. However, the dividend tax credit is much simpler and hence easier for taxpayers to understand, and its adoption would largely if not entirely eliminate the many problems of trying to trace taxes paid by corporations through to individuals, problems such as: the stale-dating of credits; insufficient creditable tax due to such matters as fast write-offs, depletion and government grants and subsidies; and the position of private utilities.²

The dividend tax credit would also tend to avoid arguments with countries with which Canada has or wishes to negotiate tax treaties arising from Canada treating the corporation tax as wholly or partly a tax on shareholders without extending the tax credit to non-resident shareholders. Further it would eliminate the discrimination against Canadian-based companies doing international business. Moreover, we do have a good deal of practical experience on how the dividend tax credit works, and it to our knowledge has never created any serious practical difficulties.

1. which could be either a different method of gross-up and credit or a dividend tax credit.
2. These problems would also be solved by a 50% gross-up and credit mechanism which operated without regard to underlying corporate tax.

The present dividend tax credit could be revised, if desired, to provide for variations in the credit at different levels of income with refunds to low-rate shareholders. This would substantially eliminate the concern expressed in the White Paper that the present dividend tax credit is worth more to high marginal tax rate shareholders than it is to low marginal tax rate shareholders.²

Further the dividend tax credit is capable of providing for reductions¹ where certain types of income not taxed to the extent felt appropriate exceeded a percentage of the total income of the corporation.

In a word, a dividend tax credit could meet the vast majority of normal situations. Special situations should be specifically provided for, rather than attempting an overall integration approach in an effort to seek one solution to a number of different and complex cases.

The corporate structure problems of integration would be avoided by continuing tax-free dividends between Canadian companies, but without the complexities of the old "designated surplus" and related provisions.

In a very real sense, partial integration which is subject to a two and one-half year payout rule, ceases to have any real value when one considers the complexities it introduces.

Closely-held Corporations

On the assumption that full integration for closely-held corporations or some form thereof may be adopted, we have the following comments:

A considerable number of small private companies will be precluded from making the partnership election if the corporation must have only one class of shares. Many companies have been incorporated in such a way that each shareholder holds both common shares and preference shares in the same or different proportions. We anticipate that efforts will be made to find ways whereby deemed distributions on a partnership election will go to shareholders with lower marginal rates than the shareholders who receive actual corporate distributions. On the other hand there will be many cases where it will be inequitable for shareholders not to be able to take advantage of the election. We therefore recommend that, consistent with preventing abuse, the right to elect be made as broad as possible. Presumably as a minimum, the only circumstances in which an election should not be available are those in which the ultimate destination of dividends actually declared by the Company may not be identical with the deemed distribution under the allocation rules.

There is no reason, in our opinion, why the partnership election should not be available where one or more shareholders are non-residents. Tax evasion in this context should prove no more of a problem than in others.

The White Paper is ambiguous as to whether the partnership election will be available where one or more of the shareholders is a trust. We can see no reason why the election should not be available in such a case.

We presume that it is intended that losses suffered by a corporation which elects to be treated as a partnership will be deductible currently from the other income of the shareholders and that such losses will be regarded as business losses in their hands, which can be carried back or forward under what is now Section 27 (1)(e). This is not the case under the present rules respecting personal corporations, but it will be impossible to achieve neutrality without such a provision.

1. A parallel is the present depletion allowance rates for shareholders.
2. A top personal rate of 50% would make this criticism relatively less serious, having regard to the average marginal tax rate of taxpayers receiving dividends.

Presumably, an election to be taxed as a partnership could be made annually and a corporation could make such an election in some years, but not in others. If so, rules will have to be devised for the treatment of distributions from such a corporation, permitting tax-free distributions in respect of retained earnings derived from years in which an election was made and taxing distributions from retained earnings derived from other years. The present rules in Section 67 of the Income Tax Act, dealing with corporations which have been at various times personal corporations and ordinary corporations, may serve as a model for such legislation.

By reason of the existence of corporation taxes in some provinces, the elective partnership proposals should have similar provincial statutory treatment in order to be effective. Two provinces, Ontario and Quebec, in which the largest amounts of corporation tax are paid, levy corporation tax at 2 percentage points above, and two others, Newfoundland and Manitoba, at 3 percentage points above, the proposed 50% rate. Paragraph 7.13 of the White Paper indicates that shareholders of corporations in these provinces will receive no credit for the additional corporation tax. In our view, every effort should be made to negotiate arrangements with the provinces which would avoid this type of discrimination.

Small Corporations

We are very much aware of the criticisms now being made against the proposal to eliminate the lower rate of corporate tax. If it is desirable to continue some form of tax incentive for "small corporations", we suggest that the present low rate on the first \$35,000 be continued for a deferral period of, say, five years. In the sixth year there would be a deemed distribution to the shareholder of any previously undistributed income of the first year and so on so that, for example, the earnings of the sixth year would be distributed in the eleventh year. The corporate surplus so deemed to be distributed might then be regarded in the same way as tax-paid undistributed income under our present laws.

The effect of such a proposal would be to postpone payment of the difference between the low corporate tax rate on the first \$35,000 of taxable income and the possibly higher personal tax rates of the shareholders for five years only. If this suggestion is adopted, we recommend that it be made available where all of the shareholders of the closely-held corporation elect to be taxed in this manner.

To ensure that such a postponement is not granted to "large corporations", we would recommend that such postponement not be available to corporations whose taxable income in any year has exceeded a specific amount, for example, \$100,000 before tax, and that the amount of the postponement be decreased as the corporate income approaches such figure. This might be based upon the formula contained in paragraph 4.31 of the White Paper.

If this suggestion was adopted, the problem of associated companies would continue, that is, the problem of distinguishing between those corporations which should receive this tax advantage and those which should not. However, as pointed out above, this problem is far less critical under a system of full integration, since it involves only the timing of tax payments. Accordingly, we suggest that the present highly technical and arbitrary rules in sub-sections (4) (5) and (6) of Section 39 be repealed and that the only provision defining associated corporations should be Section 138A(2). Given the right of appeal to the Tax Appeal Board or Exchequer Court contained in Section 138A(3), which permits the Board or Court to substitute its judgment for that of the Minister as to the reasons for the separate existence of two or more corporations, the administrative discretion conferred on the Minister under Section 138A(2) is more apparent than real and, in our view, it does not conflict with the rule of law in tax matters.

An alternative would be a "capital formation tax credit" to offset the difficulties experienced by new and small businesses in raising capital. This could take the form of a tax credit for individual Canadian residents who invested in the equity capital of small corporations carrying on active businesses, subject to appropriate conditions and limitations. Such credits could be passed on to the corporation itself where the shareholder so elected.

Tax Credit Problems

The proposal that the earnings of a corporation must be distributed by way of cash or stock dividend within two and a half years of the earning of such profits in order to preserve the tax credit may produce serious major practical problems, particularly in the early years of implementation. We think that this period is too short and we recommend that it be extended to a period of, say, 5 years.

In order to maintain the tax credit; to depress the gains resulting from re-valuation of shares of widely-held corporations every five years; to provide a saleable asset to meet capital gains tax arising out of the re-valuation of shares of widely-held companies and to retain working capital, companies would be forced to consider annual distributions of stock dividends. The cost of such distributions is substantial and unnecessary. The company would be compelled to provide a series of engraved certificates and to meet stock exchange listing requirements, while the issue and sale of the stock dividends would result in a plethora of meaningless insider trading reports.

We recommend that the government seek alternatives to the payment of cash or stock dividends in order to make tax credits available to shareholders.

Miscellaneous Matters

Although the Minister has indicated some modification of the proposals as they apply to electric, gas or steam utility companies, as a consequence of the Public Utilities Income Tax Transfer Act, it is our opinion that such taxes should be available for credit in the same manner and to the same extent as all other corporations. Transfers to provinces of revenues collected should not be treated differently whether by way of a direct transfer of the collected tax or by way of equalization payments or other methods of sharing the revenue with the provinces.

We are concerned about the transitional proposal in the White Paper (as supplemented by a technical paper released by the Department of Finance on March 19, 1970) to prevent tax avoidance by closely-held corporations and their shareholders with respect to assets such as inventory, depreciables and goodwill. We recognize that the immediate introduction of full credit for taxes paid by closely-held corporations, when combined with the full deductibility of capital losses with respect to opening share values "creates the possibility that tax could be eliminated on income which would otherwise be taxable under the present system and which should be taxable under the proposed system". Our concerns are:

(a) The proposal that tax credits be denied upon the commencement of the proposed new system until an amount of non-creditable tax has been collected equal to an amount that would have been taxable under the present system if the property has been sold, applies at the wrong point in time. No provision should become operative until the point in time when the assets which are subject to tax are sold or otherwise disposed of. To do otherwise may result in imposing a tax when a gain may not be realized for many years or not at all.

(b) We do not understand why the proposal to deny tax credits should not be consistent with the proposed treatment of surplus existing at the start of the new tax system.

We recommend that consideration be given to treating the after-tax income (when realized) created by such non-creditable tax earnings in the same manner as pre-effective date surplus so that such amounts when realized would be added to pre-effective date surplus, if any, and be treated as contemplated by the March 19 technical study.

The White Paper proposals as supplemented to date do not specify the manner in which all types of non-taxed corporate surplus will be dealt with. Under the White Paper proposals, as supplemented by technical studies, surplus arising prior to the effective date may be distributed without tax to the shareholder if the company pays a 15% tax thereon and in addition such surplus will be deemed to be the first distributed after the distribution of all surplus carrying creditable tax. Non-taxed surplus may be generated after the effective date of the proposed system from such things as incentive depletion, fast capital cost write-offs, foreign dividends, the taxation of only half the gain on shares of widely-held companies etc.

For at least certain types of corporate earnings, which are spared from tax at the corporate level, it would appear inconsistent that such earnings will be taxed on distribution at the shareholder level thus lessening the impact of the tax incentive at the corporate level. We further observe that the inter-corporate distribution of such untaxed earnings could be most unfair.

It would appear under the proposals that it is not intended to tax such distributions where the partnership election is made.

Under the existing provisions of the Income Tax Act certain of the non-taxed corporate earnings (including earned depletion and fast write-offs) would not be added to undistributed income and, given an appropriate capital structure with no other undistributed income on hand, such earnings could be distributed to shareholders by way of a stock dividend with no further tax.

It is unfortunate that the White Paper does not contain proposals as to how these surplus problems are to be dealt with. We offer the following suggestions:

- (a) At least certain of such earnings not taxed at the corporate level (such as those of an incentive nature) might be distributed without the payment of further tax.
- (b) The distribution of such earnings not be taxable to the shareholders but reduce the cost base of the shareholder until the cost base reaches zero after which such a distribution would be considered to be a taxable capital gain.
- (c) Treat such surplus or appropriate parts thereof on the same basis as the opening undistributed income.

We find unconvincing the suggestion that the necessity for providing for filing consolidated tax returns is eliminated by the proposal that certain corporations may elect to be taxed as partnerships. The conditions under which shareholders may elect to be taxed as partners may prevent those for whom consolidated returns may be appropriate from taking advantage of the partnership proposals. We recommend that the Government consider the feasibility of adopting the proposals contained in the Royal Commission Report on Taxation for the filing of consolidated returns. If, however, the Government is not prepared to allow consolidated returns, most of the problems connected with the present system could be avoided by adoption of the British system of subvention payments, under which payments made by one member of a group of corporations to another member, which would not otherwise be deductible expenses and which are made to assist the latter corporation in making up its losses, are permitted as deductions for the paying corporation and are included in the income of the receiving corporation. We are attaching as an Appendix an extract from the Association's submission to The Royal Commission on Taxation in which we described this proposal.

Business And Property Income (Chapter 5)

Rules as to Computation of Income (5.1-5.3)

All business and other expenditures except those which are purely personal should be deductible at some time or other. We believe this general principle should be confirmed in a positive statement to that effect in the Income Tax Act. Furthermore, we suggest that the statement also contain a provision that all such expenditures be deductible when made or incurred, unless they fall within a prescribed class under the capital cost allowance regulations, or unless such expenditures clearly result in the acquisition of an asset, such as land, goodwill or securities, which would not normally depreciate in value and the cost of which would be taken into account in computing the gain or loss when the asset was sold. This was the recommendation of the Carter Royal Commission¹ and we agree with it.

"Nothings" (5.4-5.5)

Pursuant to the above general principle, we believe that many types of expenditures which are now neither deductible in the year they are made or incurred, nor subject to capital cost allowances, the so-called "nothings", should be deductible in the year they are made or incurred. These include the cost of plans or investigations that are not proceeded with and other expenditures which do not result in the creation or acquisition of tangible or even intangible assets. Thus we suggest the approach already referred to of permitting the deduction of all business and other expenditures in the year they are made or incurred unless the Act specifically categorized the expenditure as one to be capitalized. A new capital cost allowance class for certain kinds of "nothings" should define specific items to be included and not take in all "nothings" regardless of the duration of any real or expected benefit.

Items not included in the new capital cost allowance class should be allowed as deductions in the year in which the outlay is made or incurred.

We are also of the view that the suggested rate of 10% capital cost allowance for the new class for "nothings" is inadequate in view of their uncertain value and duration.

Goodwill (5.7-5.8)

We are opposed to the special treatment being proposed for taxing the proceeds of the sale of goodwill of a business after valuation day. We submit that if the sale of such goodwill is to be taxed, only the net gain realized over its value on valuation day should be taxed. We know of no convincing reason for treating goodwill differently from any other asset. The fact that the goodwill of a business may have resulted partly from past efforts or expenditures does not justify retroactive taxation of goodwill existing on valuation day. Furthermore, if a taxpayer actually purchased goodwill before the beginning of the new system, there would, under the proposals, be no deduction permitted for his cost of acquiring such goodwill or its value on valuation day, but upon selling his business he must include in his income a percentage of the gross proceeds from the sale of goodwill.

We therefore submit that goodwill of a business existing on valuation day should not be subject to tax, directly or indirectly.

We do not agree with the proposal that the cost of purchasing goodwill of a business should be deductible by way of capital cost allowances. Such cost should be regarded as the cost of a capital asset to be deducted upon the subsequent disposition of such asset for the purpose of determining gain or loss therefrom.

1. Vol. 4, P. 229 and P. 247.

Entertainment and Related Expenses (5.9-5.10)

As we have already observed, we believe that all expenditures directed to the earning of income should be deductible and this also applies to reasonable entertainment expenses, the reasonable costs of attending or sending employees to conventions and the reasonable cost of dues for memberships in clubs. We oppose any arbitrary rule denying any deduction of these expenses on the ground that some abuses might occur. The only limitations to deductibility should be that the expenditures are reasonable in amount and are directed to the earning of income. There already exists a long line of jurisprudence in Canada establishing the rules for such purposes.

The proposed treatment for entertainment expenses will not result in equal treatment for all taxpayers in the same relative position. It apparently does not, for example, affect employees of employers who are tax exempt, such as governments and municipalities and many Crown corporations. It also seems to treat employees of closely-held Canadian corporations who are also shareholders more harshly than employees of widely-held Canadian corporations. Since taxes due because of non-deductibility of these expenditures are not creditable, the employee of a closely-held Canadian corporation who is also a shareholder in effect pays tax on the expenditures. In the case of employees of a widely-held Canadian corporation, the shareholders of such a corporation and not the employees would indirectly bear the tax.

The problem is really one of compliance with the existing system and the solution lies in improving methods of control rather than abolishing a recognized and bona fide business practice.

Depreciation (5.11-5.19)

We have no comment to make in this submission as to the present capital cost allowance system and rates of capital cost allowance but request the opportunity of doing so at a later date.

The first of the two proposals to close the "loop-hole" of tax postponement on depreciable property should be modified to permit a person who inherits property to add to the cost of his property all death taxes, including succession duties, and other costs incurred or assumed, such as mortgages, in respect of the property. In view of the fact that heirs may inadvertently acquire property which will, for practical reasons, have to be sold and render the heir liable to recapture of the capital cost allowance taken by the deceased, we propose that an equitable method of deferring payment of the tax on recapture be established. For example, in the case of a sale with a nominal cash payment and a large mortgage, payment of the tax should be tied to the cash proceeds realized by the heir on the sale of the property and the heir should not be expected to pay the tax from his own funds. This can be effected by an extension of the rules for deferment of income already found in Section 85B of the Income Tax Act.

We are opposed to the proposal to prohibit the deduction from other income of a loss from holding property where such loss results from capital cost allowances, interest charges or property taxes. If the capital cost allowance rates are proper, any loss resulting from the deduction of such allowance is also proper and should be allowed against any other income.

As for the third proposal, we believe that the enactment of a blanket rule denying depreciation losses on holding depreciable property and providing for a separate class for each rental building costing \$50,000 or more creates an artificial and unwarranted distinction between these taxpayers and their fellow taxpayers.

We approve the proposal to permit taxpayers to write down, for tax purposes, a class of assets to the aggregate cost of the assets of that type still on hand. However, we oppose an arbitrary rule providing for a compulsory write-down in any year in

which control of a corporation changes hands. Control of a corporation may change for legitimate business purposes, on death or other reasons not related to the sale of business losses and in many cases while the same business is continued. We object to this type of legislation which make such write-down mandatory regardless of the reasons for change in control and even when the same business is continued.

Consolidated Returns (5.20-5.22)

We welcome the recognition of the desirability of allowing groups of corporations to achieve a consolidation of losses and profits of the separate corporations. However, we doubt whether permitting a corporation to be treated as a partnership provides a solution in all cases. The right to the partnership option as proposed is subject to a number of restrictive conditions which would preclude many corporation from taking advantage of this option. We believe that corporations having common ownership should have the right to aggregate their profits and losses for tax purposes as recommended by the Royal Commission on Taxation.¹

Extractive Industries — Generally (5.23-5.45)

We are not able to express an opinion as to the precise relationship between the substantial growth in the extractive industries² since the end of the last war and the incentives that have been available but such incentives have undoubtedly been a significant factor.

In our brief on the Carter Report we expressed the view that further study should be given to the economic implications of removing the incentives particularly from the point of view of the non-tax factors which operate in the economy to determine the allocation of resources and the problems of regional development. Unfortunately the White Paper does not indicate that any further studies were conducted, or if conducted, the Government has not seen fit to publish such studies. We think it is most important that there be such a study dealing with, among other things, such factors as tariffs and the equity intensive nature of the mining industry.

Without the benefit of an extensive study it is impossible for us to either reject or accept the Government's conclusions that support on a substantially less generous scale should be suffice to continue development in the extractive industries at a reasonable level.

We are however concerned as to the future implications for the extractive industries for at least two reasons:

(a) Virtually all provinces impose an income or a royalty tax on natural resource income which is additional to the general corporation tax and as a result, when such income or royalty tax income is taken into account, the aggregate taxes imposed on the extractive industries may, under the proposals, substantially exceed the income tax burden of other industries. Even if the proposals for fast capital cost write-offs and earned depletion are taken into account, it is possible that the extractive industries will bear a heavier burden of tax than most manufacturing concerns. The Association does not feel qualified to debate whether provincial income or royalty taxes should be taken into account but if the conclusion is reached that such taxes should be taken into account we observe that the total tax impact could be very heavy.

(b) The Canadian frontier for exploration is shifting to the far North and the cost involved in exploration and development work is escalating.

1. Vol. 4, pp. 260-1.

2. The mining and petroleum industries.

In view of the foregoing reasons and other factors such as the greater emphasis on exploration and development in other parts of the world and the multinational character of many companies in the industry which may tend to locate exploration work in countries where the greatest return can be expected, it may be that if Canada wishes to encourage the growth of the industry it has to consider the after-tax rate of return for extractive operations in Canada compared with other parts of the world.

Depletion (5.36-5.44)

The White Paper accepts the view that there should be an incentive for the extractive industries. However, as we have pointed out above, we are concerned that because of federal and provincial taxes the proposed incentives may not sufficiently reduce the tax impact upon these industries and, therefore, not operate effectively as incentives. If Government studies show (or if the Government is otherwise convinced by the extractive industries) that there is justification for concern about the limiting effect of the risk incentive this might be remedied in one or both of the following ways.

(a) at least in the case of the mining industry, broaden the base for earned depletion to include as eligible expenditures¹ some or all of the following items: mine haulageways, shafts, new underground development work, smelter facilities and scientific research expenditures on mineral exploration, mining development and metal uses. As well, the cost of various supporting services related to new mine developments including road, railroads, townsites etc. might be included; and

(b) continue as a floor amount the existing percentage depletion at a reduced rate or in the alternative (because of the disincentive against exploration and development expenses inherent in net profits depletion) adjust the reduced rate to an appropriate percentage of gross profits.

There appear to be a number of technical problems arising out of the proposed incentive depletion system. Some of these problems are the following:

- (i) Expenditures on fixed assets will only earn depletion if they are "... acquired for the exploitation of a new Canadian mine". This would appear to give the new mine a substantial advantage over technological improvements in old mines which to us does not seem desirable in terms of increased efficiency and productivity.
- (ii) It appears that only properties owned by the taxpayers at the time of the publication of the White Paper will be entitled to net profits depletion during the 5-year transitional period. This provision would virtually prohibit the transfer of producing properties from one company to another during that 5-year period or indeed the transfer of any property which is about to come into production. Such transferred properties would not only lose the net profit depletion allowance for the 5-year transitional period, but would also be denied earned depletion for expenditures incurred in bringing them into production. It does not appear to us to be reasonable that tax provisions should operate to prohibit the transfer of properties in this manner and we think the effect is far too serious to be justified on the basis of expediency.
- (iii) It appears that the basis for earned depletion will impose a restriction on exploration expenditures in certain circumstances rather than create an incentive. When a taxpayer has spent more than one-half of his profits on eligible expenditures (before deducting such eligible expenditures under section 83A or its successor) he is not entitled to deduct additional earned

1. Under the White Paper Proposals, many costs incurred with new mining ventures would not be included.

depletion in that year because he has reached the maximum of $33\frac{1}{3}\%$. As well, because such expenditures are in excess of 50% of his profits the amount of depletion that he can claim in the year of expenditure is also reduced. Using the example in section 5.41 of the White Paper, it can be seen that, if the taxpayer spent a further \$1,000 in eligible expenditures, his maximum depletion for the year would be one-third of \$2,003, reducing the depletion he can claim in the year to roughly \$666. Thus, he is not only denied the deduction for the depletion with respect to the additional expenditures but his earned deductions for the year in question are reduced. We suggest that the limitation of $33\frac{1}{3}\%$ of production profits should be calculated before the deduction of eligible expenses rather than after.

- (iv) There appears to be no provision for the transfer of earned depletion credits when a property is transferred to another taxpayer. We suggest that a provision should be included for this purpose similar to the provisions contained in section 85I(3) and section 83A(8) of the Income Tax Act. These provisions would be necessary in order to avoid an artificial impediment to the transfer of properties. We also suggest that such provisions should not be limited to one or two transfers as is presently the case under sections 85I(3) and 83A(8)

New Mines (5.29-5.35)

We recognize the validity of many of the criticisms which have been made with respect to the 3-year tax-free period granted to new mines under Section 83. Nevertheless, the removal of this provision will substantially increase the taxes payable by new mines and the removal of this incentive must be compared with the adequacy of the other proposals to stimulate and maintain economic growth.

If the tax-free period is to be eliminated, we consider it advisable that the Government proposals for the fast write-off be adopted if mining ventures are to be financed into production. One of the difficulties experienced in administering the tax-free period has been the problem of determining what is a new mine. It seems that under the proposals this will continue to be an important question not only for the purposes of determining whether the mine is entitled to the fast write-off, but also for the purpose of determining earned depletion and accordingly one of the criticisms levelled against the tax-free period will continue to exist. Since only new mines will be entitled to the fast capital cost write-offs and to earned depletion in respect of fixed asset costs, there may well be an incentive to develop a new mine rather than to expand an existing mine to obtain the same production if the tax benefits are greater than the difference in economic return. In other words, there may still be an incentive to undertake a relatively inefficient operation because of the tax results.

It may well be worthwhile for the Government to give some thought to the possible continuation of a form of new mine exemption for economically depressed or remote areas as part of a program of national regional development. In general, such a regional development incentive might operate as follows:

- (a) the Government would be responsible for certifying the geographic areas where such incentive would be applicable;
- (b) the incentive would not necessarily be for a 3-year period but might be related to the total capital invested in the new mine;
- (c) the earned depletion incentive would not be applicable with respect to such new mine costs except to the extent of the residue of costs, if any, after the expiry of the 3-year period without full cost recovery; and

(d) it might be desirable to have provisions that would prevent any Canadian tax saving resulting from the incentive being taxed by a foreign jurisdiction.

Percentage Depletion for Non-Operators (5.43-5.44)

We agree that percentage depletion for non-operators should not be part of the proposed system. It may be desirable however that there be a phase-out period. In this connection we observe that in the absence of a phase-out period there may be an element of unfairness for Canadian shareholders who have considered this allowance in the acquisition price of their shares.

Exploration and Development Costs (5.25-5.26)

We agree with the Government's proposal to allow taxpayers, who do not meet the principal business test, to deduct accumulated undeducted exploration and development expenses. Paragraph 5.26 of the White Paper would however limit the right of such annual deduction to the greater of the income from mineral properties before any deduction of exploration and development expenses or 20% of the net book value of the class. We do not think the 20% limitation on the deduction of such expenses from other income is advisable. The Carter Report recommended that such expenses be deductible without limitation. Further the failure to permit full deductibility from other income may create a tax avoidance problem in that losses on the sale of shares of closely-held Canadian companies are to be fully deductible. A Canadian investor who wishes to fully deduct his exploration and development expenses would incorporate a separate company for each venture and if the venture is unsuccessful the taxpayer will dispose of the shares of the company at a loss.

Purchase and Sale of Mineral Rights (5.27-5.28)

Since it is proposed that the cost of acquiring mineral rights be deductible and that capital gains be taxable, it seems reasonable that under the proposed system the proceeds from the disposition of mineral rights should be taxable. However, the transitional rule proposed seems unduly harsh since it does not appear to allow any deduction for costs of acquisition incurred prior to the new system coming into force. For example, it would appear that, if a taxpayer had acquired mineral properties at a cost of \$1,000,000 in 1969 and disposed of the same property for the same amount of money in the first year of the new system, he would have to take into account 60% of the proceeds even though he has realized no profit or gain. It is stated in the proposals that, since the cost of mineral rights would be deductible, prices should rise after this system is brought into effect. This is hardly an assurance since the value of mineral rights depends on a number of factors, such as drilling results, location, etc. which have no tax implications. In any event, it seems hardly fair that anything other than the actual gain should be taxable.

While it appears logical in the context of the overall proposals to tax the proceeds of disposition of mineral properties, we are, nevertheless, concerned that taxpayers will have an increasing reluctance to dispose of their mineral properties if they know that they will face immediate tax on the gains. Many taxpayers will undoubtedly prefer to hold their properties in the hopes that they themselves may be able to develop the properties in such a way as to realize income without the reduction in the value of their assets which would result from the payment of tax on the gain. In many cases the owner of the mineral claims may simply not be in the position to develop the property efficiently and this may result in developments being postponed several years, thus resulting in a general slowdown of mining development. A possible answer¹ to this problem might be to allow the taxpayer disposing of a mineral pro-

1. In preparing this submission the rollover provision recommended here and elsewhere in this submission should be considered with reference to the recommended general rollover provisions for capital gains.

perty to take shares in exchange for the property and value such shares at the same cost as his mineral property without including any amount in his income at the time of disposition of the mineral property for such shares. If in such a case shares in a widely-held corporation which have a quoted market value are received as proceeds of disposition for the mineral property, the taxpayer could on the eventual disposition of such shares be required to include in his income an amount equal to the whole of the gain up to the market value of the securities at the time the mineral property was sold in exchange for such shares, the balance of the gain being treated on the same basis as holdings of other taxpayers in widely-held corporations.

Prospectors and Grubstakers (5.45)

Unless there is justification for an incentive (and we recommend that consideration be given as to whether there is any such justification), we acknowledge that the exemption for prospectors and grubstakers does not appear to be appropriate in a tax system where capital gains are subject to tax. The elimination of the provision does, however, give rise to a number of problems:

(a) Section 5.45 of the White Paper does not deal with the basis upon which the prospector or grubstaker would be entitled to deduct his cost in determining the gain upon which he would be taxable. It seems only reasonable that if the grubstaker or prospector is to be taxed on his "gain" he should be able to deduct all of his costs of acquiring the property which have not been deducted from other income and it does not seem reasonable that he should be limited to the deductions allowed under paragraphs 5.26 or 5.27. A prospector should, in particular, be entitled to deduct all of his costs whether incurred before or after the publication of the White Paper.

(b) Considerable difficulty will be experienced in valuing the proceeds of disposition of mining properties where those proceeds consist of shares. Where the prospector receives a substantial number of shares in a speculative mining company, it is doubtful that he would be able to dispose of a large block of shares at the quoted market value. Moreover, if the shares have no quoted market value, it will be extremely difficult to determine what the value of the proceeds of disposition should be. Because of these difficulties it is likely that the prospector will insist on receiving cash for his mining properties to avoid the possibility that he might have to pay tax on more than he can eventually realize. It also seems probable that many prospectors will insist on arrangements under which they do not dispose of their property, but continue to exploit it in some form of partnership thus creating many awkward forms of arrangements for the exploitation of natural resources. If the prospector insists on cash this may very well increase substantially the cost of mineral exploration in Canada. At the present time, property costs are reasonably low because the prospector is usually willing to take shares in a company in lieu of cash and hope for the best. If the exploration is not successful, his shares will be worthless but a large cash outlay is avoided by this method. For these reasons, if the prospector receives shares there should be a rollover on the same basis as is outlined above in the case of the purchase and sale of mineral rights.

(c) There will also be a problem in determining the cost to an acquiring company of the property acquired from the prospector where the consideration consists of shares. Will this cost be the market value of the shares, their par value or some fair evaluation of the value of the property acquired?

(d) As we pointed out under the heading "Purchase and Sale of Mineral Rights" above, the taxation of the proceeds from the sale of mineral properties will result in some reluctance on the part of prospectors to part with their properties and this may result in delaying the development of potential natural resources. There will be an

incentive to the prospector to try if at all possible to arrange his own financing for the property in question rather than diminishing his capital base by a transfer.

Effect of Proposals on Corporate Structures of Mining and Petroleum Companies

One of the effects of the proposed system for taxing corporations and their shareholders is that whenever untaxed income arises in a corporation the income will be subject to tax whenever it is paid out by way of dividend to an individual or to a corporation (unless the paying corporation is a closely-held corporation in respect of which the partnership option can be exercised). In the case of mining companies, untaxed income can arise from at least two sources; (i) capital cost allowances may be claimed considerably in excess of book depreciation with the result that the company may have income which can be distributed, but which has not borne tax, and (ii) untaxed income will arise by virtue of earned depletion deductions. The effect of this is that, if the income of the company is distributed, all of the benefit of fast capital write-offs, and earned depletion will be lost.

One of the strange effects of the system is that the only type of shareholder who does not suffer from this problem is the non-resident who owns shares directly in the operating company. Such a shareholder gets the full benefit of the so-called incentives even though distribution takes place. The non-resident who holds shares through Canadian companies may be able to restructure his Canadian holdings in such a way that the impact is avoided and the Canadian company may be able to avoid additional tax in its subsidiary companies so long as it can structure its subsidiary holdings in such a way that it can exercise the partnership option with respect to its subsidiary holdings. Unfortunately, such restructuring will require substantial corporate reorganization with transfers of assets in order to create closely-held corporations. Such restructuring will not only involve large expense, but will also create structures which may not be desirable from the standpoint of business efficiency.

We submit that the tax system should not force substantial reorganizations and restructurings of corporations and that a way should be found to relieve inter-corporate dividends from tax so that these effects can be avoided. It also seems reasonable that payments out of untaxed income should not be subject to further tax in any shareholder's hands where such taxation will result in double taxation. Perhaps such distribution should be treated as a return of capital reducing the cost base of the shares to the taxpayer.

Trusts (5.55-5.58)

This report on the Trust Section of the White Paper is in a rather different form than our other suggestions because we interpreted the comments of the White Paper on this subject as an invitation to do much more than comment on the Government's own conclusions. We decided that possibly no other group in Canada was as able to assist the Government in this field as the Canadian Bar Association. The following pages actually design a system for taxing trusts to replace the system which is very briefly described in the White Paper. We then go on to suggest some possible compromises between the two systems. Our comments relate exclusively to the problem of personal trusts, rather than business trusts.

Background

At the risk of pointing out the obvious, we recommend the following quote from a speech made by Edwin S. Cohen, Assistant Secretary of the United States Treasury

for Tax Policy, earlier this year when he was speaking on one of the subjects to which we are addressing ourselves, the taxation of accumulation trusts:

"Accumulation trusts serve a very important function in providing a means for the conservation and investment of property for minors and other persons. The Treasury and the Congress are well aware of the desirable features of such trusts, and the valuable services of banks, trust companies and other professionals in acting as fiduciaries. We have no desire to cause the tax laws to interfere with their use. At the same time, we must give careful attention to the opportunities for tax reduction that are implicit in accumulation trusts, and the serious inroads which they can make into the equity of the income tax structure, particularly with regard to the operation of the progressive tax rate scale".

We note the Government's frank statement in the White Paper that its studies on the uses of trusts in Canada have been incomplete. We understand that the Trust Companies Association is prepared to assist with, and perhaps even finance, a definitive study in this field. We could undoubtedly contribute volunteers with experience in this area. Our first suggestion then is that, rather than produce bad provisions based on inadequate knowledge, the Government might delay its reform of the law relating to trusts pending the studies described.

Related to this point is the implication in the White Paper that there is a large and growing tax loophole by the accumulation of income in trusts. Our observations lead us to think on the contrary that the number of trusts set up for motives of tax saving through accumulation is small, and that the amount of revenue lost through these is compensated many times over in total by the extra tax paid in accumulation trusts due to the absence of personal exemptions. Having said this, however, we agree with the White Paper that there is no reason why reform should not be attempted to try to prevent income-splitting for tax savings by the use of trusts.

Further, we wonder if the framers of the White Paper had observed, as many of us had not until recently, that as the result of the capital gain provisions in the White Paper, almost every trust will in the future be an "accumulation trust", instead of a small fraction of trusts as is the case now. By this we mean that virtually every trust is set up with income going to one beneficiary and capital to another, or to the same beneficiary at another time. Under trust law a capital gain will accrue to the remaindermen, rather than to the income beneficiary. Thus, even a trust providing for full distribution of income currently will involve two sets of income taxes, one paid by the income beneficiary on what he receives, and one paid by the trust out of the capital account on any gains made by that capital, including any stock dividends declared as a result of the White Paper. These capital gains, or stock dividends, are treated for tax purposes in the same way as income accumulations. The implication of this conclusion is that the law involved in taxing accumulations is not an obscure corner of taxation inhabited only by sophisticated tax planners. It is, on the contrary, a basic provision squarely in the mainstream of tax life of the Canadian public. The White Paper suggests a simple, but very onerous solution, thinking perhaps that its burden could be avoided by simply avoiding accumulation trusts. As this paragraph suggests, this is an over simplified view. The point in this paragraph, combined with the suggested graduation of capital gains taxation, is one reason why solutions to this problem used by other countries may not be useful in Canada.

The apparent underlying policy of the White Paper proposal is that it is better for a very large number of people to pay an unfairly large tax if this is the only administratively convenient way of preventing a very small number of people

from paying too little tax. We believe that this conclusion is basically wrong, and especially wrong in this area. One inequity cannot be solved with another. We think, first, that in any compromise administrative convenience should be the first area of sacrifice, and, second, that where an arbitrary tax rate has to be fixed, there is no justice or logic to simply picking the highest possible rate. If we are sacrificing equity to convenience, the rate picked should be a mean rate, even though this produces a tax too generous to some and too onerous to others.

Our specific criticisms of the White Paper scheme are:

- (i) The proposed rate is unfair for most trusts, and punitive of trusts generally.
- (ii) The undeveloped idea in the White Paper referring to the relieving provisions only in the case of testamentary trusts and only where the testator was relatively poor is an insufficient gesture towards equity.
- (iii) It is not the remaindermen only who will suffer as the result of the over-payment of tax, it is the life tenant, whose future income will be cut down when a proposed rate is inappropriate by the reduction of the amount available for investment in the hands of the trustees.
- (iv) There is no mention of credit for corporation tax paid although we assume this will be allowed to the trust nor is there mention of a deemed realization for capital gains on distribution of the trust although we assume this will **not** be the case.

Model for the Application of Income Tax to Trust — Review of Theory

The following is our model for tax designed as an alternative to the White Paper proposal. The White Paper proposal is simple, with few concessions to equity. Our model is completely equitable, with few concessions to administrative convenience. In it trusts are considered to be either inter vivos settlements or trusts created by will. No distinction is drawn between the two types. However, later in this submission we do draw a definite distinction between “simple” and “complex” trusts. In our conclusion the great number of trusts will fall in the “simple” category and what we refer to as the “first tier of taxation” does full justice to the taxing process. This is the application of tax at the time the income is received by the trustee. Only in the complex trust do we consider it necessary to apply what we call the “second tier of taxation” or taxation when the trust is distributed.

Our primary assumption is that a trust is not in essence an entity separate from its beneficiary but instead must be considered in relation to its beneficiary as a single tax entity. Our submission follows in other words the theory that a trust should be considered in the nature of a conduit pipe in which flows of income enter at one end and move unchanged into the hands of beneficiaries at the other end.

This theory presents absolutely no problems to the extent that the income does in fact flow but, of course, given the almost unlimited number of variables in the terms of a trust and the circumstances in which a trust is operating, there are certain to be innumerable occasions when income flow will be interrupted within the conduit itself so that it becomes a matter of some difficulty to ascertain the precise beneficiary against whom the tax is to be applied.

The inclusion of capital gains in the taxable base is bound to increase the number and extent of these deflected flows. By its normal wording a trust involves the retention of capital sums including realized capital gains for a greater or lesser period and similarly this normal wording involves the pay-out of the income arising from the capital. Hence in the normal instance the person who is entitled to receive the income

is readily ascertained but in the normal instance the person who is entitled to receive the capital is far less certain and subject to many possible contingencies depending both upon the probable length of the trust and the variables set out in the trust document. While taxes based on capital represent an enlargement of the difficulty we do not consider that they prevent a unified solution of the problems. In other words we believe that a workable solution to the handling of the income flow will also provide a workable solution to the handling of the capital gain flow.

The primary consideration to be kept in mind is that the taxes we are considering are all applied on an annual basis and the calculation of tax is an annual calculation. In every trust there must be—in our phrase—a calculation of a **“current taxable amount”** each year. To the extent that the payments out of the trust represent the current taxable amount, the persons who will bear the tax are, of course, those beneficiaries who receive the amount. It is a simple procedure to report this transmission of the amount and carry the amount into the tax return of the beneficiary. The problem in trusts is, as we have indicated, the fact that the current taxable amount will not necessarily flow to an ascertained beneficiary in the year in which it arises in the hands of the trustees of the trust although it must inevitably flow to the hands of a beneficiary at some eventual date. After reviewing all current methods it is our first conclusion that no completely satisfactory method of levying tax against a trust exists which permits finality of taxation in each separate annual tax period. We have concluded that there needs to be a **“first tier of taxation”** based on the annual taxable amount arising in the hands of the trustees. This prevents deferral of tax. Because of the possible inequities of a system exclusively based on the first tier approach, we think it is essential to adopt a **“second tier of taxation”** to allow for the adjusting of tax. In our view this must take place in the year of the physical distribution of the taxable amount.

Recommendations Upon the First Tier of Taxation

The first tier of taxation consists in part of those amounts which are distributable annually and hence can be taxed accurately in the hands of the beneficiary. The first tier of taxation must also, we conclude, be applied to the balance of any current taxable amount which is unallocated to a beneficiary in the hands of the trustees. Our recommendations in dealing with this involve the concept of the **“presumptive beneficiary”**. By this we mean the persons to whom the amount would be distributable **had the terms of the trust called for final distribution in that specific tax period**. The unallocated amounts can be composed exclusively of what would be classified as accumulated income, or can be composed exclusively of capital gain or can include both. The handling of the problem is not affected by the nature of the taxable amount.

We have set out five problem situations as samples to evaluate our proposals. The first is the holdback for administrative reasons. The second is the trust for accumulation. The third is the discretionary type trust. The fourth is the power of appointment type trust. The fifth is the foreign beneficiary type trust. We believe the problems are found in a blend of one or more of these areas. The concept of the “presumptive beneficiary” can be applied without undue difficulty in all of the five cases. The applications we propose for the first tier are as follows and are all based on the assumption as to who would be entitled to the fund if the fund were distributed in the year.

Class 1—Uncertainty for Administrative Reasons.

Wills and trusts are, of course, subject to litigation or problems of interpretation. An heir may challenge the validity of a will or a widow ask provision be made for

her under The Dependents' Relief Act. There may be several fiscal periods during which the prospective beneficiaries are unknown.

If the potential beneficiaries are in doubt **we think the taxable amount should be attributed to the persons who would take if the trust were void.** This is a normal procedure to a Court. The beneficiary is the settlor himself, if he is alive and would normally be the next-of-kin of the settlor, if he is dead.

Class 2—The Accumulating Trust

A trust for accumulation may be specifically for the benefit of an ascertained individual or individuals. For example, a fund may be allowed to accumulate while a person is under a particular age and then paid over to that person. Accumulations may also be accidental in the sense that the funds are held to provide an annuity for a beneficiary and more income than needed is earned in a year. Accumulations may also be part of a plan to regenerate capital. Where it is felt income is not immediately required, an accumulation may be directed or permitted.

All of these accumulations must have an ultimate beneficiary or group of beneficiaries or the trust is void. **All of the group who are in existence in the particular year will be presumed to share equally.**

Class 3—The Discretionary Trust

This is the case of authority being given to trustees to decide from time to time who receives and how much. It can apply as to income or capital or both. To avoid being void at law there must be an ascertainable class of beneficiaries within which group the trustee must distribute although the amount and recipient is unknown.

If the trustees have failed to exercise the discretion, **then all persons who qualify as the ultimate beneficiaries will be presumed to share equally.**

A classic example is a trust "income to wife for life with power to encroach for her benefit and remainder to my children". The proposal is to allocate any undistributed income to the children. Another example is a trust "income to such of my children as my trustees decide but with power to accumulate and remainder to my grandchildren". The proposal is to allocate any accumulation to the grandchildren presently in existence.

Class 4—Power of Appointment Trust

This is very like Class 3 but the authority to select is given to someone other than the trustees and in the normal case the power to select is usually exercisable once rather than periodically and relates to the ultimate distribution of the trust. A class of beneficiary is still essential. The common example is a husband's Will allowing his widow to direct the manner in which the residue of his estate will be divided amongst their issue.

This would be handled in the same manner as the discretionary trust. To the extent the power is not exercised, the **current taxable amount will be attributed in equal shares to all of those who qualify for appointment.**

Class 5—Foreign Beneficiary

This is not so much a problem of trust law as a problem in tax law and distinction in rates. A presumptive beneficiary who is non-resident in the year would be treated **as qualifying the trust for the appropriate non-resident rate of tax to the extent of his interest.**

The trustees can by use of these rules and without undue burden allocate most current taxable amounts to specific individuals. If an individual is resident in Canada

the trustees can obtain his individual taxation number and report the income to the tax authorities. The crux of our approach at this level is to suggest that if computer procedures are as efficient as has been suggested, the tax authorities can add the taxable amount to the tax return of each beneficiary (probably, however, out of necessity it will be added to the beneficiary's prior year return) and then bill the trustee for the tax attributable to that additional amount. It is, of course, essential that the tax bill should be paid out of the trust and not paid by an individual regardless of the strength of his expectation.

It is only in those rare instances in which no prospective beneficiary has a physical existence—or perhaps does not have a tax existence—that tax at any arbitrary rate need be adopted and we suggest a figure of 25%.

If the beneficiary is a non-resident of Canada, the applicable tax would be based upon the non-resident withholding rate.

Recommendations as to the Second Tier of Taxation

We have concluded that if year by year we can relate the initial withholding tax to the individual rates of prospective beneficiaries, substantial justice has been done to the claim for taxes in the year in which the income is earned and there will be little reason for adjustment in the year of distribution in all those trusts which we describe later as "simple" trusts. The second tier, however, forms the basis for an easily handled adjustment in the year of distribution for those trusts in which there is some provision making it possible to choose the beneficiaries at the time of distribution.

We think it is unnecessary to re-open prior tax years for beneficiaries and relate distributions to the year in which they were earned although this is the essence of the amendments currently being proposed by the Nixon administration in the U.S.A. However, unless averaging provisions are made more flexible we do think it is essential that beneficiaries be allowed to elect that lump sum payments may be taxed at an average rate of tax perhaps following the method of the present Section 36.

When a trustee comes to distribute trust funds the taxable amount of that trust fund can be ascertained by a number of different methods. The method is unimportant if a single beneficiary receives everything but very important if several beneficiaries share, either at the same time or at subsequent times. We think it important that the basis of allocation should be as a proportion of the whole trust rather than any other method. Each distribution should have attributed to it a proportion of the taxable amount in the hands of the trustees and also a proportion of the credit for tax paid by the trustees. All that is involved is the recording by the trustees of a running tally of the total tax paid out and of the total taxable amount retained. The only area of difficulty is the ascertainment of the relationship between any present payment and the total capital on hand but we think this can be done effectively by either basing it upon the book value of the assets on hand and distributed or the market value of assets on hand and distributed.

Examples

The following are some examples of the working of the model, in particular showing the result for various tax credits.

I. Creditable Corporation Tax

The example used is:

A trust deed provides—"income to wife for life and on her death remainder to two children X and Y, power to pay capital at any time to X or Y".

The income payable to the wife is treated as her income and is therefore not analyzed here.

If we assume a capital increase in a year by a stock dividend from closely-held corporation of \$2,000 on which the creditable tax is \$2,000, the tax accounting is as follows:

Tier No. 1

The taxable amount (\$4,000) and creditable tax (\$2,000) is allocated 50% to X and 50% to Y and reported to the Department of National Revenue in the estate T3 tax return for the year. This will give the names and social security number of the two remaindermen. National Revenue examines their prior year's returns and reassesses tax on this \$2,000 of income as if it formed additional income in each return. The assessment is returned to the trustee who pays any tax or receives any rebate. If we assume in the example that the total tax assessed to the trustee is \$1,000, then the trustee has creditable tax of \$2,000 and therefore receives a refund of \$1,000.

The trustee then notes on his ledgers:

Tax paid accumulation (\$2,000 + \$1,000).....	=	\$ 3,000
Creditable Tax.....	=	1,000
		<u>\$ 4,000</u>

These figures are accumulated year by year until there is a distribution out of the funds.

Assume the life tenant dies and the figures at that time are:

Tax paid accumulation.....	\$ 7,000
Creditable tax.....	3,000
	<u>\$10,000</u>

Tier No. 2

The trustee distributes the estate to the two beneficiaries reporting one-half of the accumulation and tax credit to each on the appropriate "T3 form".

Each beneficiary bring into his personal income tax return for the year the following:

Trust income (\$3,500 + \$1,500).....	\$5,000
Creditable tax.....	1,500

The beneficiary pays tax upon this amount as part of his income for the year taking advantage, however, of any averaging or other options made available to him.

II. Credit For Foreign Tax Paid

The only foreign taxes which need concern us are those for which allowance can be claimed against Canadian income tax. The solution for this then is relatively easy: that is, to allow as a tax credit to the trustee, at the Tier #1 stage, only the amount of the foreign tax which the Income Tax Act allows any taxpayer against his Canadian tax.

For example: a Trust is directed to accumulate income until the beneficiary is 21. It received \$1,000 in dividends from a closely-held corporation and \$1,000 in dividends from U.S. corporations (from which \$150 was withheld at source).

The tax calculation for Tier #1 is

Canadian dividend.....	\$ 1,000	
Creditable tax.....	1,000	
U.S. dividend—net.....	850	
U.S. withholding tax.....	150	
Taxable amount.....	\$ 3,000	
Tax at the beneficiary's rate—say 10%.....	300	
Canadian creditable tax.....	\$ 1,000	
Credit for U.S. withholding tax @ 10%.....	100	1,100
Refund \$1,100—\$300.....	=	800

If this were to be taxed again on distribution at Tier #2, the trustee would show:

Tax paid income—dividend CHC.....	\$ 1,000
—dividend U.S.....	850
—rebate.....	800
	\$ 2,650
Creditable tax.....	300

(There is a lost credit for \$50).

A trust with those provisions, however, does not call for a second tier of taxation when the distribution is made to the beneficiary and hence the beneficiary receives the sum of \$2,650 as a capital distribution.

III. Capital Cost Allowance

Same trust as in I but the trust asset is an apartment building, and \$500 is deducted from gross rents and transferred to capital as depreciation. For trust purposes this accumulation is added on the ledger to the trust capital, that is, the “original capital” not the “accumulation capital” and would appear to have no tax implication at all.

If the amount of the capital cost allowance is paid to the life tenant as income (which some trustees will do in these cases), the income tenant takes it as a tax-free receipt and once again there would appear to be no tax implication.

IV. Depletion

The result here is analogous to that for capital cost allowance. In both cases there is a sum of money which is tax-free and not an adjustment to tax, and whether the trustee allocates it to the income or capital account would appear to make no difference to the taxation of accumulations.

Conclusion and Recommendations

We have recommended that there be no second tier of tax in the case of “simple” trusts; by this we mean all trusts where the prospective beneficiaries are ascertained, subject only to new births or unexpected deaths, and where the only discretionary possibility of interrupting the inheritance is a power of encroachment for the benefit of the life tenant. This would include the vast majority of all trusts, and even though there would be some sacrifice of equity to simplicity, we feel the first tier described in our model would do justice to taxation. The Department of National Revenue may feel, however, that even a power of encroachment in favour of a widow as life tenant could produce some undesirable income tax splitting, particularly when the remaindermen are young children with low tax rates. If this is thought to be in-

tolerable, then the single tier would have to be confined to trusts with no discretionary element allowing a choice between beneficiaries.

We do, however, feel that both taxpayers and the Government need our two tiers for more complex trusts; that is, trusts with discretion to encroach to remaindermen, trusts with power of appointment of capital attached to them, and trusts where there are no apparent prospective beneficiaries. We believe that the distinction between "simple" and "complex" would not be too hard to define.

The foregoing is a complete tax system which can be criticized for complexity (although it is far less complex than the U.S. system) but one which does not sacrifice equity for simplicity.

What are the alternatives, or compromises, between the White Paper and our suggested plan?

Possible Compromise

A possibility for compromise (which we would recommend if our system is unacceptable) would be to simplify the taxing rate for the first tier of taxation. This could be done consistently with equity because any rate that in retrospect was a mistake could be corrected by application of the second tier. The availability of the second tier on the other hand takes on greater importance. The various possibilities are as follows:

1. One possibility is to adopt a flat rate as the trust rate in every case. We have already set out our own reasons for rejecting this approach, but a rate substantially less than the maximum is still a possibility.

2. A further possibility is to continue the present system of treating the trust as an individual, to be taxed on undistributed income at personal rates.

3. Another possibility is to apply the tax rate of the settlor or testator based on a rate obtained as an average over several years.

4. Another possibility is a system of ministerial discretion. We reject this completely as a compromise, on the ground that tax rates should be set by Parliament and not by the Minister of National Revenue.

We do, however, feel that all of these alternatives offer a much less logical system than the one we have proposed in our model. The great virtue of our first tier proposal is that we are attaching a tax rate to appropriate shares of taxable income giving effect to what is the probable basis of distribution. It is as if the distribution of all income took place year by year. In the great majority of trusts we expect it will in fact be distributed in the way it has been allocated.

In any event, we feel that any compromise to obtain simplicity in the first tier rate will increase inequities. This is, we think, satisfactorily cured in the second tier, so far as our present model is concerned, but were there large inequities at the first tier then we would want to suggest a system of compound interest at a realistic rate to be charged or allowed if any over or under payment of tax became apparent as the result of second tier calculation. Even such a system as this does not compensate the life tenant for reduced income if the first tier taxes on the capital are unduly high.

Taxing International Income (Chapter 6)

In making the following submissions we have assumed that Canada's tax treatment of international income must follow and be compatible with its domestic taxation system especially as it applies to corporations and their shareholders. We also recognize that there are opportunities for tax avoidance by Canadian residents in the present tax system which should be corrected if reasonably possible. The present tax system has however the virtue of simplicity which tax reform should aim to preserve.

We have dealt with the subject of international income under the following headings:

- Foreign-Source Income of Canadians
- Capital Gains of Non-Residents
- Canadian Income of Non-Residents

Foreign-Source Income of Canadians (6.8-6.33)

We find inherent in these proposals an attempt to preserve some of the simplicity of the present system in the case of income from tax treaty countries while at the same time eliminating avenues of tax avoidance through the use of tax havens.

We endorse the White Paper proposal to continue the present system under which dividends received by a Canadian corporation from a controlled foreign corporation in which it holds more than 25% of the issued voting share capital are exempt from Canadian tax in the hands of the Canadian corporation but in the case only where the source of the dividend is in a country with which Canada has a tax convention. We suggest, however, that this result should also apply where the Canadian corporation has a substantial interest in the foreign corporation but less than 25% of the voting power.

There is a proposal to change the present system to require that dividend income received by a Canadian corporation from such a subsidiary in a country with which Canada does not have a tax treaty be grossed up and a credit be given for the foreign income taxes paid. This introduces complexity and an arbitrary line of distinction. We have considered possible alternatives to the treaty, non-treaty distinction such as continuing the present treatment where the source country's tax is above some reasonable level. However, we have concluded that such an alternative would be more complex, just as arbitrary and quite likely not as effective from a standpoint of opportunities for avoidance. Given the objectives, the White Paper proposal should in our view, be adopted, subject to the proviso, however, that if Canada does not succeed in expanding its network of tax treaties, Canada revert to the system contained in Section 28(1)(d) of the present Income Tax Act.

We note, however, that Canada has in the past derived tax revenue which might not otherwise have accrued to Canada by the use of tax havens through Canadian corporations. An example of this is where operations are carried on by a corporation incorporated in a tax haven which is a subsidiary of a Canadian corporation which in turn is a subsidiary of a foreign corporation. The profits of the subsidiary in the tax haven are remitted by way of dividends to the Canadian corporation free of tax but on being passed up by way of dividends to the foreign parent company produce withholding tax payable to Canada. If the White Paper proposals are implemented a number of such tax haven subsidiaries will undoubtedly be taken over by parent companies in other countries and Canada will lose the withholding tax which it has heretofore collected. It should be mentioned however, that some countries such as the United States have eliminated this device. Corporations in other countries where this is not prevented by domestic tax legislation continue to

incorporate subsidiaries in Canada to hold their tax haven investments. We are not aware how substantial a source of revenue this remains for Canada.

We recognize a problem however, in connection with those countries which are not tax havens in the usual sense and with which Canada is not able in the future to negotiate tax conventions. We have in mind specifically those developing countries which may offer a tax incentive to foreign investors by way of a low rate of tax on corporate profits or by way of a "tax holiday". If Canada does not take such incentives into account in her tax treatment of profits flowing from ventures in such countries, the effect of the host country giving tax incentives would be nullified and the result would probably be that they would not be granted at all to Canadian-owned corporations since the net effect would merely be a shift of tax from the host country's treasury to the Canadian treasury. We have not been able to find a solution to this problem which would flow the tax incentive through to the Canadian corporation ("tax-sparing") and which would at the same time achieve the objective of taxing in Canada other forms of untaxed international income. It appears to us that the only solution consistent with the basic scheme of the White Paper is that proposed in the White Paper, that is, of expanding the number of Canada's tax conventions with other countries. Accordingly, we approve of the proposal to expand the number of Canada's tax conventions with other countries as well as the intention which is stated in the White Paper of delaying the implementation of certain of the international tax proposals until the tax treaty network has been so expanded. An alternative would be if Canada unilaterally extended treaty exemptions to certain developing countries where treaty negotiations failed and Canadian investment in such countries is substantial.

We have considered the proposal that a system similar to that currently used in the United States to tax "passive income" of Canadian-controlled foreign corporations be instituted for Canada. We question whether or not there should be a distinction between passive and ordinary income. While we recognize that the objective of the proposal is to tax foreign-source passive income currently to the extent that it has not borne tax abroad, we suggest that Canada should limit its concern to preventing the diversion to tax havens of income which would otherwise have been earned in Canada. We have serious misgivings concerning the complexity and inconvenience both to taxpayers and the Department of National Revenue alike flowing out of the passive income approach. We find it difficult to make specific comments on the passive income proposal since it is not described in detail in the White Paper but we would like the opportunity of studying the draft legislation if and when it is prepared. We also are of the view that it would be prudent to delete the passive income proposal from any initial legislation to permit further study and consideration of other alternatives. We also wish to point out that the present Income Tax Act contains provisions relating to corporate residence and non-arms-length transactions which, if actively utilized by the Department of National Revenue, would adequately counter tax haven evasion schemes.

We support the proposal to allow "15 percentage points of foreign withholding tax to pass through a Canadian corporation and qualify for credit treatment in the hands of the final shareholder". There appears to be some doubt whether this flow-through will extend through a chain of Canadian corporations so that the benefit will ultimately accrue to the shareholders of the parent company especially where the income in question crosses the Canadian border more than once. If the flow-through does not extend to the ultimate shareholder the proposed domestic gross-up and credit system would produce a severe tax penalty. We suggest that consideration be given to a free flow of dividends between corporations in restricted

cases or alternatively an extension of the partnership option approach proposed for closely-held companies.

The effect of paragraph 6.17 of the White Paper as it applies to a Canadian shareholder in a Canadian company which controls a foreign corporation in a non-treaty country is not clear. We assume however, that the effect would not be to give a Canadian shareholder credit against his personal income tax for the underlying foreign corporate taxes but only for the withholding taxes which may have been imposed by the foreign country.

Capital Gains of Non-Residents (6.43-6.47)

We submit that the proposal to tax non-residents on their capital gains realized on assets situate in Canada (other than gains on shares of widely-held Canadian corporations where less than a 25% share interest is owned) presents problems of compliance and enforcement. It would not appear difficult in some cases for example, for non-residents to avoid or postpone the Canadian tax by interposing foreign corporations to hold Canadian assets. We recognize, however, that special provisions may be necessary to prevent tax avoidance or deferral on capital gains by Canadians who invest in non-resident corporations which have certain kinds of investments in Canada.

As the White Paper indicates, this proposal depends for its implementation on Canada re-negotiating most of its present tax conventions with other countries as such treaties now exempt such gains from tax in the country where the asset is situated.

Even if Canada's tax treaties are successfully renegotiated to permit Canada to tax the capital gains in Canada of non-residents, enforcing the collection of such taxes would appear to be a difficult task particularly where a sale of Canadian property is between two non-residents. In addition most countries which impose capital gains taxes regard gains made by residents of their countries on sales of shares in foreign companies as domestic source income. If Canada were to impose capital gains taxes on such non-residents, serious problems of international double taxation would arise. In our view, therefore Canada should adhere to the present international practice of leaving it to the country of residence to tax capital gains in the shares of Canadian companies. This practice however, may form the subject of modification by future tax treaties between Canada and other nations.

Canadian Income of Non-Residents (6.34-6.42 and 6.48-6.49)

With the exception of the provisions relating to "Thin Capitalization" and "Branch Profits Tax", the common feature of the proposals relating to the taxation of non-residents is the necessity to renegotiate existing tax treaties. Accordingly, the proposals are open to general criticism in that they depend on a matter not wholly within the control of the Canadian government and, assuming that the premises upon which they are based are sound, suggest that alternative methods of achieving the stated objectives should be explored.

It may be asked whether the proposed increase in the non-treaty withholding tax rate is required to deal with the specific abuses described in the White Paper which, it is felt, flow from the fact of a low Canadian rate of withholding tax. One abuse particularly referred to is described in paragraph 6.4 and it is suggested that this problem could be dealt with in a more effective manner than by means of an increase in the withholding tax rate. If this abuse exists, it must be with respect to Canadian residents who so organized their affairs as to take advantage of the low Canadian withholding tax rate and the fact that dividends can be received free of

Canadian tax from controlled foreign corporations. Consideration should be given to dealing with this problem by removing the dividend exemption in those cases in which the income used to pay the dividends has its source in Canada.

It is noted that in paragraph 6.39 of the White Paper the government proposes to remove the exemption from withholding tax on interest paid on certain obligations, notably municipal, provincial and federal bonds where the recipient is not a resident of a country with which Canada has a tax treaty. We assume that the reason behind this proposed change is the prevention of abuses by Canadian residents. We question, however, whether the assumed objectives could be accomplished better by providing an exception or rebate of the tax where the recipient discloses with supporting evidence the identity and country of residence of the beneficial owners of the security.

We consider the proposal relating to non-resident owned investment corporations ("N.R.O.'s") as being of crucial importance in the taxation of non-residents. We believe that large pools of capital are now held by holding corporations incorporated in Canada because of Canada's reputation as being a stable country with favourable tax conventions with other countries and no foreign exchange control. In order to retain this kind of capital in Canada we propose that N.R.O.'s be treated for all practical purposes as non-residents with the rate of N.R.O. tax dependant on the country in which the shareholders are resident; i.e. 15% for treaty country residents; 25% for non-treaty country residents. To prevent abuse of such a dual rate in the event that the shares are sold by shareholders resident in a country with which Canada has a tax treaty to purchasers resident in a non-tax treaty country, a withholding tax equal to the difference between the withholding tax rates applicable on dividends to shareholders in the two countries could be imposed on any distributions of undistributed income existing at the date of sale.

It may be suggested by some that this would give Canadian residents the opportunity of evading tax by using nominees to hold the shares of an N.R.O. We feel that there is adequate machinery in the present statute to counter blatant schemes of tax evasion without denying the N.R.O. concept for bona fide non-residents.

It would also be consistent with the White Paper proposals to permit many presently existing holding corporations to elect to become N.R.O.'s by expanding somewhat the statutory definition of N.R.O.'s. This would put shareholders of such companies in the same position as if they held their Canadian investments directly. The advantage to Canada would lie in keeping the capital in Canada and in collecting the N.R.O. tax earlier than withholding tax.¹

We also submit that N.R.O.'s should not be subject to tax on capital gains if non-residents in the same situation would not be subject.

By expanding the type of income which must be received by an N.R.O. to qualify for the special status, it would be possible to alleviate the position of companies which are now "foreign business corporations" within the meaning of the Income Tax Act. Failure to deal effectively with the foreign business corporation problem will, we feel, lead to the removal of such companies from Canada.

It also follows from our submissions on N.R.O.'s that gains by non-residents on the sale of shares of an N.R.O. should not be taxed if the non-resident would not have been taxed if he held the assets of the N.R.O. directly and had realized a gain on their disposal.

It is conceded in the White Paper that the application of the proposal to restrict the deductibility of interest in certain cases is necessarily arbitrary and difficult

to administer. The stated concern is that profits that otherwise would be taxable in Canada at full rates are sent out of the country as interest subject to tax only at the withholding tax rate. We agree that in certain cases Canadian tax may be reduced in this manner but it is to be hoped that provisions will be included from the outset providing for relief in appropriate cases² and that the implementation of such provisions will not be left "to a later date". It should be pointed out, however, that it is our experience that the interest rate charged on many non-arms-length loans of this kind is often less than a market rate. The result of the White Paper proposal would probably be that in such cases the interest rate on a smaller loan would be greater and the aggregate amount of interest paid and deductible just as great. It would also be helpful if the government clarified its intentions with respect to the application of the proposal. Will it apply to interest obligations incurred prior to implementation of the proposal? How will it be applied—will all interest be disallowed or only that portion relating to the debt that is in excess of the stated ratio?

1. (which is all Canada would get if the non-residents were to use a non-resident holding company).
2. (for example where the debt-equity ratio of the parent company is greater than 3 to 1).

PART B

Taxation of Professional Income (Chapter 5-5.46-5.47)

The Canadian Bar Association does not agree with the implication in the White Paper that lawyers as members of a profession have received some "unwarranted advantage by comparison to the rest of Canadians" and the suggestion that some change in our tax laws is required until we "catch up to other Canadian businessmen".

This implication arises from the right of lawyers heretofore to account for their income for tax purposes on a cash basis as opposed to an accrual basis. We note that in 1967, 8.1 million individuals filed tax returns and of these 6.2 million were employees who have always filed tax returns on a cash basis. No suggestion is made in the White Paper that this be changed until they "catch up" with all other taxpayers. A great many lawyers in Canada practise their professions as employees and file returns on a cash basis and there is no suggestion that this should change. The White Paper, therefore, which generalizes about taxpayers in the professions, seems to be speaking of those professionals only who are proprietors.

Unlike tradesmen and other businessmen, however, lawyers and many other professionals have been precluded from carrying on their vocations through corporations which would have had a number of tax advantages.

Some of the more obvious advantages are the relatively low rate of tax on the first \$35,000 of income; deferment of tax through pension plans; income and estate splitting with wives and members of the businessman's family; and a maximum tax rate of about 50% for the more successful.

In addition, all corporations and other taxpayers have been permitted to report investment income, interest, dividends, etc. on a cash basis and there is no suggestion that this should change.

We think that our disagreement with the presumption in the White Paper that lawyers as members of a profession have received an unwarranted tax advantage in relation to other Canadian taxpayers is well justified. Farmers and fishermen have been permitted under the present Income Tax Act to report their incomes on a cash basis, average their incomes and suffer no recapture on depreciable assets when sold. These Canadian taxpayers are more numerous than lawyers and all other professionals combined and yet no suggestion is made that they have received an "unwarranted tax advantage" or that any change is necessary or desirable.

The White Paper proposes that lawyers be required to compute their incomes for tax purposes on the higher of the cash basis or the accrual basis of computing income until they "catch up" to all other taxpayers. This means that lawyers would be required to include in income the higher of the amounts actually received or the amount by which year-end closing receivables and "inventory" exceed opening receivables and "inventory" less any increase in trade debts payable.

Many lawyers practising in Canada do not maintain time records, particularly in small firms and in firms practising in areas where substantially all of their fees are determined by a tariff. It is also often the case where firms confine their practices to specific branches of the laws. As a consequence, as of the commencement of the proposed change, there is no practical method for determining the cost of work in process. If, in these circumstances, the cost or value of such work in process is fixed at nil, the entire amount would have to be brought into the 1971 income and would impose an abnormal tax liability in that year as recognized in paragraph 5.47.

We are not convinced that the transitional provisions have been adequately considered by the Government. As a result we can only condemn the transitional provisions proposed in the White Paper not only as they apply to lawyers but to all professionals as being inadequate.

Apart from the deficiencies in the transitional proposals, the fact of being required to compute income on an accrual basis as contemplated would, in our view, place Canadian lawyers in a position of disadvantage compared to any other non-professionals now required to report income on an accrual basis. We acknowledge that businesses which buy goods for resale or buy raw materials to manufacture into goods for sale can most accurately compute income in accordance with accepted accounting practices by taking account of, *inter alia*, changes in inventories from one accounting period to another. Such inventories are generally offered for sale and are traditionally consistently valued at the lower of cost or market.

"Inventories" in this context, we submit, are more accurately described in the traditional U.K. terminology as "stock-in-trade", i.e. tangible goods offered for sale. It is obvious that lawyers do not purchase tangible goods for resale nor produce tangible goods for sale. In fact, it is extremely doubtful that the work in process of a lawyer is inventory within the broad and vague definition of inventory which has been contained in the tax laws of Canada for many years. If, in fact, inventory as so defined does include the work in process of a lawyer, substantial problems of valuation arise.

Under the Income Tax Act, "inventory" is to be valued, *inter alia*, at the lower of cost or market. We submit, "value" where inventory in the event market is lower than cost means the amount that one might expect to realize if at the significant point in time it was necessary to offer such "inventory" for sale. The work in process of a lawyer is not saleable at all and therefore in this context it has no value.

Similar problems arise if the significant factor is "cost". One of the accepted accounting methods of costing inventory for tax purposes is the "direct cost method". Under this method, only the cost of the direct labour and materials used to produce the "inventory" is to be taken into account in arriving at cost. In the case of a lawyer practising alone there is no cost in this context because the compensation the lawyer receives at the end of the fiscal period is profit. In the face of this accounting principle, it becomes obvious that two lawyers practising in partnership will be exposed to a very different tax liability than a proprietor and employee lawyer even where such employee is compensated on the same basis as one of two partners without the concomitant liability. Such a result might lead all members of every law firm to practise as partners with minimum guarantees to those partners who would otherwise be employees. We oppose tax proposals which would induce law firms to resort to this form of tax avoidance or lead the Government to resort to legislative corrective measures which might inhibit or restrict for tax reasons the formation of the more traditional forms of legal partnerships.

In addition, in the case of "custom" work, the Courts have endorsed the "completed contract method" of computing income. All work done by a lawyer is custom work and on this basis no inventory arises.

Lawyers in some provinces are permitted to take litigious work on a contingent fee basis, that is that they only earn their fee if their client is successful. In such cases we submit that the work in process should be valued at nil.

The second element in the computation of income on an accrual basis is taking account of changes in closing accounts receivable compared to opening accounts receivable, and changes in accounts payable. Lawyers' accounts payable fall into

the same category as any other business account payable but accounts receivable do not. Unlike most trade receivables, lawyers' accounts are not specifically payable on a 30, 60 or 90 day basis. In fact, in most Canadian provinces, lawyers are unable to enforce collection of their accounts receivable until such accounts have been "taxed" by the Master or other similar court officers of the respective Superior Court of the province in which the lawyer carries on his practice. As a result, such accounts receivable may be outstanding for a relatively long period of time. To this extent they may not properly be regarded as "current assets" and are obviously not assignable as security for financing prior to taxation as normal trade debts are. The accounts receivable of some professions quite clearly cannot be collected by other than professionals rendering the service. If it is intended to require lawyers to account only for the receivables that have been "taxed", we would not be opposed.

It is our position that apart from all other considerations lawyers in one sense stand in a relationship to their clients much the same as employees with their employers, rendering only personal services. To require them to report income on an accrual basis while others in similar positions report on a cash basis is an unwarranted discrimination.

To the extent that any abuses may exist by reason of deliberate failure to seek payment for services completed, we believe that certain arbitrary rules can be adopted to prevent such abuse. The proposed reduction of the high rates of personal tax to a maximum of 50% minimizes any inducement to defer receipt of payments.

One alternative solution might be the averaging on a cash basis of the last two months' income of a fiscal period and the first two months' income of the following period. The Association would be happy to cooperate in the formulation of such rules.

We submit that the White Paper proposal may have a retroactive effect during the transitional period. Accordingly we would appreciate the opportunity of reviewing and commenting on the transitional provisions when they have been drafted.

APPENDIX

The following is taken from the brief submitted by The Canadian Bar Association to The Royal Commission on Taxation on January 11, 1964.

It seems anomalous that, while a corporation can deduct a loss incurred from the profit realized from another business, this principle does not extend to the situation where one corporation in a related group has a profit while another has a loss. This treatment results in a considerable juggling of assets and income amongst the various companies of the group, which creates business difficulties and should not be necessary. These difficulties would disappear if the companies could net their profits and losses and pay tax only upon the net amount. It would not, in our opinion, be necessary to provide for the filing of consolidated financial statements, in which intercorporate transactions are eliminated, as long as the profits and losses are netted.

The privilege of paying tax on the aggregate of gains or losses of a related group of companies should be available where during the whole of the year in question substantially all of the shares of one company are owned by another or where substantially all of the shares of two or more companies are under common ownership during the whole of the year.

One problem in connection with aggregating gains and losses arises in connection with the treatment of loss carry-forwards. It is suggested that there would be little difficulty if losses carried forward by one company were available to be deducted by another company only if the losses were incurred in years when the companies were subject to common control.

It is RECOMMENDED:

That where substantially all of the shares of one or more companies are owned or controlled by another, throughout the whole of a taxation year, for that year, all of such "related" companies be permitted to pay tax on the aggregate of gains or losses of all such companies, including the carry forward or back of the aggregate loss against aggregate income within the general time limits provided for the carry forward and back of losses.

A useful alternative solution to this problem is provided by Section 20 of the U.K. Finance Act, 1953, under which, where a company with a net profit reimburses an affiliated company for a net loss sustained by the latter the payment, which is termed a "subvention payment" is treated as a deductible expense of the payor and as taxable income of the payee. Under the U.K. statute the following conditions are required—

1. The payment must be made pursuant to a prior agreement of the paying company to bear or share in losses, or a particular loss, of the payee.
2. The payment must not be such as would otherwise be includable in the income of the payee or taxable to the payee by withholding of tax at the source.
3. The payment must be made before the end of the tax year following that in which the payee's loss period ends.
4. Both companies must be resident in and carrying on business wholly or partly in the United Kingdom.
5. Both companies must be "associated", that is, one must be a subsidiary of the other or both must be subsidiaries of a third company. A company is treated as a subsidiary of another if 75% or more of its voting stock is held by the latter.

APPENDIX "B"

A Submission By

**The International Nickel Company
of Canada, Limited**

On The

Proposals for Tax Reform

MAY 1970

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Summary

This Submission deals with various aspects of the White Paper's proposals specifically as they relate to Inco and the mining industry. Inco believes that the White Paper's proposals need to be analyzed and evaluated against a background of a relatively new phenomenon: the fact that the Canadian mining industry is encountering increasing competition from ore bodies situated in foreign countries. This is particularly true of nickel: 80 per cent of the world's known nickel reserves are today outside of Canada. This fact places a special urgency on maintaining a tax system that would both encourage exploration in Canada and allow Canadian deposits to effectively compete with foreign deposits. This would make possible the continued development of Canada's mineral resources with all that it means for the economic development of the country. Inco does not believe that the White Paper's proposals meet these tests.

The White Paper's proposals effectively withdraw the long-standing tax incentives applicable to Canada's mining companies and make Canada's mining industry its most heavily taxed industry.

Thus, under the White Paper's proposals, the marginal tax rate for the mining industry in Ontario will be 59 per cent as compared with 52 per cent for manufacturing industries.

Additionally, proposals contained in the White Paper would put Canadian companies at a very real competitive disadvantage in undertaking foreign mining ventures. The White Paper's proposals would sharply increase International Nickel's taxes and would thus limit its ability to continue to develop the country's resources.

Had the proposals been fully implemented in 1960 through 1969, Inco's taxes would have been increased by 74 per cent and its earnings reduced by \$30 million annually.

Inco is currently nearing completion of its more than \$1 billion program begun in the mid-1960's to sustain and expand its production in Canada. This program stimulates regional development which the provincial and the federal governments wish to encourage. It will increase direct employment in Canada by 7,500, maximize local processing of ores, increase exports, and be a stimulant to secondary industry. Applying the White Paper's proposals to this program

shows that the net earnings generated by it would have been reduced by 27 per cent. Such a reduction in profitability, had it been known at the inception, would have resulted in a greatly reduced program. Rather than a program to increase nickel production by more than 30 per cent, the Company estimates that it would have been forced to cut the investment program by \$500 million. This would have permitted nickel production to increase to less than 500 million pounds a year, rather than the more than 600 million pounds a year in its present program.

Assuming the full implementation of the White Paper's proposals in 1970, the Company's studies show that it would be subject to an increase in income taxes during the 1970's of 60 per cent. The resultant decline in earnings would force the Company to defer development of three and possibly four mines in the Sudbury area it now has under active consideration; substantially curtail exploration and hence postpone further development of the 100-mile Moak Setting Belt in Manitoba; and divert the bulk of its exploration efforts to countries outside of Canada.

The White Paper's proposals would result in Canadian mining taxes being far heavier than the taxes imposed on mining in foreign jurisdictions.

Examples:

- The income tax burden on Inco's Coleman mine, which is presently being developed, would be 55 per cent higher in Canada than it would be if it were located in the United States.
- The income tax burden on Inco's total operations would be 30 per cent greater under the White Paper's proposals than under the Australian tax system and 50 per cent greater than under the U.S. tax system.
- Under the White Paper's proposals and comparable investment criteria, the rate of return on a large investment that Inco is currently considering in a stable foreign jurisdiction would be 39 per cent greater than the return on a large Inco investment in Ontario.

In broad terms, the White Paper's proposals would force a static posture on the Company's Canadian operations. It would mean that the Company would shift far more of its exploration to foreign countries, and thus the bulk of its future expansion would be abroad. While Inco would continue to mine and process its existing Canadian ore bodies, it would be forced to limit its Canadian exploration program and could only replenish its ore reserves where it could find deposits that could stand the very high taxation burden implicit in the White Paper's proposals. The proposals would prevent large tonnages of low-grade Canadian deposits from being mined. The result would be that the Company, rather than being a dynamic stimulator of the economy, a force in regional development, a growing employer and a growing exporter, would become a relatively static entity. Projects it is currently developing, such as its new mine and mill at Shebandowan, Ontario, or ones that it is currently considering, such as the Moak

Setting Belt area in Manitoba, or the North Range area in the Sudbury District, would or could not be undertaken.

Inco believes that its alternative proposals would maintain a climate favorable to economic growth in Canada and be fair to all Canadians, and would tax the Canadian mining industry in a manner that would permit it to effectively compete with the mining industry of other nations. Inco believes that its proposals are appropriate relative to the taxation of other Canadian industries, particularly in view of the Canadian mining industry's proven efficiency which has been achieved without benefit of tariffs. Inco's specific recommendations are:

- Retaining an important measure of percentage depletion but at a reduced rate of 20 per cent; adopting the concept of earned depletion but altering it to give an incentive to those companies that maximize domestic processing of Canada's mineral resources; and limiting the combined value of both incentives to the present maximum of $33\frac{1}{3}$ per cent of production profits.
- Modifying the three-year exemption for new mines so that it would apply to undeveloped mining areas only. This exemption would encourage continued regional development.
- Modifying the proposed tax treatment of shareholders to avoid features in the White Paper that discriminate against holders of shares in resource, international and growth companies. Inco believes that the tax credit granted Canadian shareholders should continue to be related to dividends actually received rather than to taxes paid by a company.
- Retaining the principle of the present system under which no additional tax burden is placed on Canadian companies doing business abroad. This exemption would permit Canada to participate in the development of important, known metal sources outside of Canada—a development that will take place with or without Canadian participation. The White Paper's proposals put a Canadian business such as Inco at a competitive disadvantage with a comparable U.S. or foreign business operating abroad. The proposals would inhibit Canadian companies from investing in developing countries.

The Company also believes that further study of the revenue implications of the White Paper's proposals is needed. This Submission contains in an Appendix an economic analysis that suggests that under the existing system—and even more so under the White Paper's proposals—revenues from the personal income tax and therefore total revenue, will increase markedly over the next few years. If this is so, the extent of the tax increases proposed in the White Paper is unnecessary. Incentives for the mining industry can and should be objectively evaluated on their merits.

I. Introduction

This Submission by The International Nickel Company of Canada, Limited is made in response to requests from the Standing Committee on Finance, Trade and Economic Affairs of the House of Commons and the Standing Senate Committee on Banking, Trade and Commerce for comments and suggestions on the *Proposals for Tax Reform*,¹ published in November 1969.

In this document, International Nickel examines some of the effects that the White Paper's proposals would have on the Canadian economy. Specifically, Inco evaluates the impact of the Government's proposals on the ability of the Canadian mining industry (1) to grow within Canada, and (2) to operate effectively outside of Canada in the face of changing production and marketing conditions and competition from companies based in other countries.

The remainder of this chapter discusses the significant role of this Company in the growth of the mining industry in Canada and the worldwide competition with which Canadian mining will be faced in this decade. The subsequent chapters discuss in some detail the effect of implementing those of the Government's proposals that are of special significance to Inco as a Canadian-based company with substantial international interests. Where appropriate, practical alternatives are proposed. Certain economic aspects of the Government's proposals are examined and a reappraisal of the Government's revenue calculations is suggested.

A. THE COMPANY

The International Nickel Company of Canada, Limited was incorporated in Canada 54 years ago in 1916. Its immediate corporate ancestor began operations here in 1877. Inco has approximately 84,000 shareholders, of whom 58 per cent have addresses in this country, 39 per cent in the United States and 3 per cent in other countries. Canadian residents hold an increasing proportion of the Company's shares—31 per cent at last count. U.S. residents hold 55 per cent and residents of the United Kingdom, France and other countries 14 per cent. The market value of the shares of Inco owned by Canadians is greater than that of the shares owned by Canadians in any other Canadian company with the exception of one public utility.

¹*Proposals for Tax Reform*, The Queen's Printer, Ottawa, 1969. Hereafter in this Submission sometimes called "the White Paper", *Proposals*, or *Proposals for Tax Reform*.

International Nickel operates eleven mines in Canada: nine in the Sudbury District of Ontario and two at Thompson, Manitoba. The Company does virtually all of its processing² in Canada—approximately 95 per cent of all its process costs are incurred in this country. More than 95 per cent of the Company's nickel and 40 per cent of its copper is exported.³

The Company's facilities include:

- Two smelters in Ontario and one in Manitoba.
- An iron ore recovery plant in Ontario.
- A copper refinery in Ontario.
- Nickel refineries at Port Colborne, Ontario; Thompson, Manitoba; and Clydach, Wales.
- Precious metal refineries in the United Kingdom and Ontario.
- Two rolling mill complexes: one in the United States and one in the United Kingdom.
- Seven research laboratories: three in Canada, two in the United States and two in the United Kingdom. All of Inco's process research is carried out in Canada.

The Company has more than 34,000 employees in some 18 countries, of whom 25,500 are employed in Canada.

B. INCO'S EXPANSION IN CANADA

International Nickel is now in the middle of a more than \$1 billion Canadian expansion program that began in the mid-1960's and will reach its major objectives in 1972. The principal components of this expansion are five new mines in the Sudbury District of Ontario; a new mine and mill at Shebandowan, 50 miles west of Thunder Bay, Ontario; three new mines near Thompson, Manitoba; a new nickel refinery and two new mills at Copper Cliff, Ontario; and extensive supporting surface facilities in Ontario and Manitoba. This program, which commenced before publication of the Carter Report, has as its objective increasing the Company's nickel production by more than 30 per cent to approximately 600 million pounds annually in 1972, and its copper production by more than 25 per cent to about 420 million pounds.

International Nickel's ore reserves in Canada have been increasing each year as a result of the Company's continually expanding exploration program, together with advances in mining and processing techniques developed by Inco that enable it to treat grades previously considered uneconomic. The greater part of the ore that the Company is now processing contains less than 1 per cent nickel. This requires Inco to spend heavily on additional milling and processing facilities because it must process more ore to recover the same amount of nickel.

²The term "processing" here refers, generally, to all of the milling, smelting and refining of ores down to the finished metal sold by Inco.

³Based on 1968 statistics.

WORLD PRODUCTION OF NICKEL
(Millions of Pounds, By Country of Source)

TABLE 1

	<u>1960⁵</u>	<u>1968⁵</u>	<u>1975⁶</u>
CANADA	429	527	820
Guatemala	—	—	60
Dominican Republic	—	—	63
United States	25	28	27
Other America	—	3	4
America	<u>454</u>	<u>558</u>	<u>974</u>
Australia	—	11	125
New Caledonia	118	176	447
Australia and Oceania	<u>118</u>	<u>187</u>	<u>572</u>
Finland	5	7	10
Greece	—	11	26
Europe ⁴	<u>5</u>	<u>18</u>	<u>36</u>
Indonesia	1	15	40
Philippines	—	—	75
Asia	<u>1</u>	<u>15</u>	<u>115</u>
Africa	7	20	88
TOTAL NON-COMMUNIST COUNTRIES . .	<u>585</u>	<u>798</u>	<u>1,785</u>
USSR	128	227	330
Cuba	32	79	100
Poland	3	3	3
Other Communist countries	<u>5</u>	<u>12</u>	<u>22</u>
TOTAL COMMUNIST COUNTRIES	<u>168</u>	<u>321</u>	<u>455</u>
TOTAL WORLD	<u>753</u>	<u>1,119</u>	<u>2,240⁷</u>

Percentage of Canadian production to:

A. Non-Communist Production	73%	66%	46%
B. Total World Production	57%	47%	37%

⁴Excludes Communist countries.

⁵*Metallgesellschaft Aktiengesellschaft*, 56th annual issue, 1969.

⁶Based on estimates by The International Nickel Company of Canada, Limited.

⁷*Fortune*, in an independent survey (March 1970, p. 102), estimates that, by 1975, world nickel production will approximate 2.5 billion pounds, of which Canadian production will amount to only 32 per cent.

C. TRENDS IN WORLD NICKEL PRODUCTION

Table 1 on page 1 - 3 shows that Canada's present position as the world's dominant supplier of nickel cannot be counted on to last through the coming decade and that Canada will face increased competition from outside the country.

In 1960, Canada accounted for 73 per cent of the non-Communist world's nickel production. At that time, the bulk of the world's production came from sulphide ores, of which the Sudbury basin was by far the most important source. By 1968, Canada's share had declined to 66 per cent. By the mid-1970's, an increasing proportion of the market will be supplied by lateritic, or oxide, ores found outside of Canada in the tropical and sub-tropical countries of the world, radically changing world production patterns. By 1975, despite planned substantial increases in Canadian nickel output, Canadian production is expected to account for less than half of the non-Communist world's nickel supply and only about one-third of the entire world's nickel supply. During the coming decade, therefore, Canada faces declining relative importance as a nickel producer.

These foreign ore bodies are going to be developed in any event. It is therefore of prime importance to Canada that International Nickel and other Canadian mining companies with their overall competence and technical know how participate to the greatest extent possible in the development of such ore bodies. Inco has projects in various stages of exploration or development in Guatemala, New Caledonia, Minnesota, Indonesia, Australia, and the British Solomon Islands Protectorate. A number of non-Canadian companies—both newcomers and existing nickel producers—are expected to play an increasing role in nickel production.

The 1970's will see an increased worldwide demand for nickel. The sharpest increase will come from those nations—such as Japan—and from those nickel users—such as steel producers—that are attempting to develop their own sources of supply. Despite the increased demand for minerals, however, Canada will face sharply increased competition in markets where it is now, but cannot necessarily be expected to remain, dominant.

It is obvious, therefore, that the price of nickel in the coming decade will be determined by conditions outside of Canada. Because of this, and because of the fact that in the long run many potential users of nickel can and will substitute other metals if the price of nickel rises materially,⁸ it is highly questionable whether Canadian nickel producers will be able in the future to pass on the cost of increased taxes in the form of higher prices.

The 1970's will see a further internationalization of business patterns as people and markets are bound closer together by improvements in transportation and communication and by the harmonization of commercial, manufacturing, financial and marketing

⁸This point is developed in detail in Appendix L of Inco's brief on the Carter Report (delivered to the Minister of Finance in September 1967), copies of which may be obtained from the Company upon request.

methods. A sharply increased proportion of investments will be made through multinational companies—with or without Canadian participation.

The Government must ask itself these critical questions:

1. To what extent does it want Canadian production to share in the increase in world demand for minerals?
2. To what extent does it want Canadian mining corporations to be able to participate in projects outside of Canada?
3. To what extent does it want the Canadian mining industry to be able to continue to contribute to such stated Government objectives as regional expansion and a favorable balance of payments?⁹

The tax framework within which the mining industry must work in the 1970's will in large part determine the answers to these questions.

⁹See Appendix A, which shows that Inco's direct impact on Canada's balance of payments in 1968 amounted to more than \$550,000,000.

II. Mining Industry Incentives

A. THE GOVERNMENT'S POSITION ON TAX INCENTIVES

The Government's basic position on tax reform related to the resource industries can best be summarized by the following:

The Government has decided that some special rules should still apply in determining the income derived from the mineral industries, in order to encourage exploration for and development of mineral deposits. These inducements are intended to encourage the establishment and growth of highly productive industry in areas of Canada outside those where rapid urban and industrial growth are already occurring . . .

(*Proposals for Tax Reform*, paragraph 1.50.)

. . . The extra inducement offered in the mineral industry through the "earned depletion" and the immediate write-off of capital costs of new mines should continue to attract capital from Canadian sources and abroad, in competition with the resources and investment conditions offered in other countries . . . All in all, the mineral industries would continue to be stimulated by some tax measures not offered to other industries, but not to as great a degree as under the present law.

(*Proposals for Tax Reform*, paragraph 8.48.)

Accordingly, the Government proposes the following changes:

1. *Earned Depletion*—The present depletion allowance of 33⅓ per cent of net profits would be eliminated. This provision would take effect almost immediately on any properties acquired after November 7, 1969, and by 1976 on properties acquired before November 7, 1969. An "earned depletion" allowance would replace the present incentive. The allowance would be based on one dollar in depletion allowance for three dollars of (a) expenditures made on plant and equipment for new mines, and (b) expenditures relating to "exploration for or development of mineral deposits in Canada."¹

2. *New Mines*—The three-year exemption from tax on income from a new mine would end on income earned after December 31, 1973.

As an alternative, the capital cost of mining equipment and buildings acquired for a new mine could be written off as rapidly as desired against the profits of the new mine, instead of being claimed as a deduction over a period of years as is now permitted.

B. INCO'S ANALYSIS OF THE GOVERNMENT'S PROPOSALS

In paragraph 8.48 of the White Paper, the Government expresses the

¹*Proposals for Tax Reform*, paragraph 5.40.

view that while the overall effect of its proposals on the growth of the mining industry cannot be forecast with any certainty, it is not expected to be serious. After careful study, Inco has reached a contrary conclusion: if the Government's proposals are implemented, there will be a substantial and serious reduction in mineral exploration and, subsequently, in development and mining in Canada.

1. *Mining Would Be Highest Taxed Industry*—In any discussion of the White Paper's impact on Inco, it must be remembered that the Company must operate under dual federal-provincial tax systems.

In addition to sharing in corporate income taxes, the provinces have imposed taxes on mining profits for many years. The top marginal tax rates under the existing systems of provincial mining taxes are noted in Table 2 below.

TABLE 2

**PROVINCIAL MINING PROFITS TAX
CURRENT MARGINAL RATES**

British Columbia	15%
Ontario	15%
Quebec	15%
New Brunswick	12%
Manitoba	11%
Saskatchewan	9%
Newfoundland	5%
Nova Scotia	(a)
Alberta	NIL
Prince Edward Island	NIL

(a) 3% on income in excess of \$10,000 up to \$1 million, 5% on the next \$4 million, and an additional 1% on each of the next \$5 million.

It is abundantly clear that, when considering the feasibility of a project, the federal and provincial corporation taxes and the provincial mining taxes must all be taken into consideration, since they together constitute the impact of income taxation on the revenue from the project. While most provincial mining taxes are deductible in computing income for income tax purposes, full deductibility is not allowed in certain cases because of the technical provisions in the Income Tax Regulations.

Table 3 on page 2-3 indicates the impact of the White Paper's proposals on combined federal and provincial top marginal tax rates in the provinces in which Inco operates, and contrasts these rates with the overall effective rates applicable to companies engaged in manufacturing or trading.

TABLE 3
COMBINED EFFECTIVE MARGINAL TAX RATES

	Mining			Manufacturing
	Corporate Income Tax	Mining Profits Tax ³	Total ⁴	Corporate Income Tax
ONTARIO				
Present Combined Rates				
(Excluding temporary surtax) . . .	35% ²	10%	45%	52%
White Paper Combined Rates. . . .	52%	7%	59%	52%
MANITOBA				
Present Combined Rates				
(Excluding temporary surtax) . . .	35% ²	7%	42%	53%
White Paper Combined Rates. . . .	53%	5%	58%	53%

During the 1960's, Inco spent an average of \$21 million a year in exploration for ore bodies, and for plant, equipment, and development of new mines, which would have been classified as "eligible expenditures" under the White Paper's proposals. This included the largest mining exploration program carried out in Canada over the decade.

In addition, during the 1960's, Inco committed an annual average of \$60 million in risk capital in expanding its mining and production facilities and in improving its plant to handle the output from the new mines that it developed in the period. These expenditures would not have qualified as eligible expenditures under the Government's proposals.

Despite these enormous expenditures, Inco would, under the White Paper's concept of "earned depletion," have been entitled to an average reduction of only about three percentage points in its effective tax rates over the decade. This reduction would have been less than one-fifth of the incentives that were provided under the existing depletion system.

The conclusion seems clear: even with an unparalleled level of risk expenditures, Inco would have received little benefit from the "earned depletion" proposal, and would have paid taxes at higher effective rates than those applicable to manufacturing companies.

The proposal would have a similar effect on other mining firms. Instead of receiving an effective incentive as the White Paper indicates, the mining industry would in general become the highest taxed industry in Canada.

2. *Tax Rates of Canada's Competitors*—A most important factor in assessing the adequacy of the proposals related to mining investment is the resultant effective overall corporate tax rates compared with similar rates in other countries competing for mineral risk capital.

²After giving effect to the reduction in the normal 52% and 53% corporate tax rates due to the present 33 1/3% depletion allowance.

³Effective rates after giving recognition to the full deduction of the 15% Ontario and 11% Manitoba mining profits taxes from income subject to corporate income tax.

⁴Because the above rates are marginal rates, they do not reflect the impact of mining tax processing allowances or the proposed earned depletion allowances. The Company's average tax rates would be slightly less than those shown above. The exact reduction would depend, among other things, on the level of "eligible expenditures," which will vary from year to year. For Inco, the White Paper's average combined rates would be higher than the tax rates for manufacturing.

Appendix B shows that Canada's corporate income tax rates on mining income would be substantially higher than those of many other developed countries that want to encourage mining, including the United States where the federal rates range upward from 24 per cent (and are typically around 30 to 35 per cent), and Australia where the rate is generally 36 per cent.

Appendix C compares the tax provisions relating to mining in some of the developing countries of the world, in all of which Inco is exploring or has explored within the last decade. The effective rates in these countries are all substantially below those proposed by the Government.

These two appendices make it clear that there would be compelling reasons for switching exploration and, subsequently, mining investments to areas outside of Canada. The Government's proposed tax rates do not represent a constructive policy for a country that still has an enormous job to do to develop its resource potential.

3. *Provincial Revenue*—A reduction in mining incentives that slows down mining development and discourages mineral production would result in a proportionately greater reduction in the revenues of the provincial governments than the federal Government, because of the provinces' greater reliance on resource taxes. Any slowdown in resource development and production would therefore result in revenue losses to the provinces at a time when their revenue requirements are increasing more rapidly than the federal Government's.

4. *Investment Flow*—Inco and other Canadian mining companies are already faced with increasing operating costs arising from the mining of lower grade ores and the fact that ores are being mined in more remote regions which requires large expenditure for infrastructure. Companies such as Inco are often required to provide townsites, transportation, and other facilities in remote locations. When these factors are combined with the Government's proposal to impose sharply higher effective tax rates on the mining industry, it is obvious that investment in Canadian exploration and development would be discouraged and some ore reserves that are currently mineable would become uneconomic. Faced with lower after-tax earnings, Canadian and foreign mining investment would increasingly shift to the many countries whose effective tax rates for mining are more competitive than those proposed for Canada.

There is little reason to believe that capital and other resources diverted from mining by the Government's proposals would flow into Canadian manufacturing industries to any significant extent. This capital is usually provided by corporations with a particular interest in resource development, and would be diverted to foreign mineral developments in countries with relatively more favorable tax systems.

5. *Fairness and Neutrality*—It has been argued that mining tax incentives are "non-neutral" and therefore divert capital from other uses that would be taxed more heavily. This argument is unsound for several basic reasons. First, it considers only one aspect of Government fiscal policy and ignores, for example, the highly non-neutral

custom tariffs, which significantly favors most manufacturing but is unfavorable to mining and the extractive industries, who must sell their products on world markets. (See Appendix D where it is suggested that, because of other significant non-neutral factors in the Canadian economy, the benefits of overall neutrality are more nearly achieved by the retention of substantial mining incentives.) Second, it ignores the special problems and risks of investment in the mining industry. Third, it fails to take into account the special and unique contribution of mining to the achievement of national and regional growth objectives.

6. *Exploration Trends*—In examining Inco's exploration program over the past decade, two distinct trends become apparent:

a. Total exploration expenditures have increased—from \$8.6 million in 1960 to \$21.5 million in 1969, and

b. The proportion of Inco's total exploration costs spent outside Canada has tripled—from 9 per cent in 1960 to 28 per cent in 1969.

This first trend in Canadian exploration can be attributed in part to the fact that operations must now be conducted in remote locations because the more accessible mineralized areas have already been explored. This has meant increased costs in exploration drilling, and increased investment in research, equipment and highly qualified personnel.⁵

The second trend relates directly to the necessity for Canadian companies to remain competitive in the global hunt for minerals against intensified competition from foreign resource companies.

Both these factors must be carefully considered by the Government in designing meaningful incentives. If the proposed tax rules are adopted, the only prudent decision for Inco would be an immediate, complete re-evaluation of the Company's Canadian exploration program. The same decision would be faced by the entire mining industry. In devising tax legislation, the Government should carefully consider whether the resulting cutbacks in exploration would lead to material restrictions in economic and regional growth.

7. *Regional Growth*—Mining development is of paramount importance for economic growth in the remote areas of Canada. If the Canadian North is to reach the stage of supporting new jobs and new communities, the only viable way is through the discovery and development of natural resources.

The Department of Regional Economic Expansion is embarking on a new program to assist areas of slow economic growth, which generally fall below the 53rd parallel. While this program is useful in promoting the growth of certain existing regions, resource incentives also balance Canadian expansion by encouraging the development of remote areas that have no existing economic base. The Western

⁵For a thorough review of the trends in Canadian mineral exploration, see Special Study #11, "Earth Science Serving The Nation", by the Science Council of Canada. Note also that the Solid Earth Science Study Group responsible for Study #11 has submitted an important brief to the House Of Commons Standing Committee on Finance, Trade and Economic Affairs concerning the possible effect of proposed tax reform on mineral exploration in Canada.

provinces, the Yukon and the Northwest Territories are just entering their most vigorous phase in the development of their resource industries. It would seem most unwise to embark on policies that would choke off this kind of development.

If Canada is ever to reach its real economic potential, a strong incentive for exploration and development must be retained in the tax system. The new towns, jobs, schools, roads and railways that are created as a result of such risk development are an admitted benefit from growth in Canadian mining.⁶ The town of Thompson in Manitoba, which did not exist a decade ago, is now the third largest population center in Manitoba. Yesterday's Thompson is being paralleled by today's Faro in the Yukon—and so on.

C. INCO'S ALTERNATIVE PROPOSALS

Inco proposes the following alternative incentives for the mining industry:

1. *Depletion*—

a. Continue the percentage depletion allowance at a reduced rate of 20 per cent, but calculated on net profits before deduction of exploration and development expenses (commonly referred to as Section 83A expenses), combined with

b. A modified "earned depletion" concept that would allow companies to deduct an additional dollar of depletion allowance for every three dollars spent on "eligible expenditures." These would include all exploration and development expenses, and all new capital expenditures related to mining and processing in Canada.

c. Limit the total of both depletion allowances to no more than 33 $\frac{1}{3}$ per cent of net production profits, with an unlimited carryforward provision for earned depletion not fully utilized.

2. *New Mines Exemption*—Modify the three-year tax exemption for new mines so it would apply to pioneer mining areas only as part of an enlarged Canadian policy of regional expansion. The exempt income would be limited to the lesser of the first three years' income from the new mine or the total capital invested, and established mining communities such as those existing within the Sudbury District would be excluded from the provisions.

Inco's proposals, as outlined above, would result in some reduction in the level of incentives presently available to the Canadian mining industry. Under Inco's proposals, some mining companies would continue to enjoy something approaching the present level of tax incentives, while other companies, including Inco, would pay more taxes. No mining company would pay less taxes than under the present law. Inco is convinced that its proposals would provide for the continuation of a reasonable level of incentives to the Canadian

⁶This point was made in a speech at the University of Sydney on March 16, 1970 by The Honorable Charles W. M. Court, Western Australia's Minister for Industrial Development and the Northwest: "Well planned regional infrastructure generates consequential growth and diversity of activity to back up and later even take over from minerals and continue the economic growth on a stable permanent basis."

mining industry and would at the same time improve the present incentive system. Specifically, Inco's proposals would result in an important part of the depletion allowance being calculated on the basis of a mining company's total commitment to mining exploration, development, processing and other capital costs, while also recognizing the necessity for retaining an important measure of percentage depletion. This latter feature would allow Canadian taxes on mining to remain competitive with those of other countries that are also trying to attract mineral risk capital.

The Company proposes that a limited exemption be granted for income derived from a new mine in an undeveloped area away from established communities because of the special risks and the overall benefits associated with such developments.

International Nickel believes that its proposals for taxation of production profits would be effective in maintaining the important contribution of the mining industry to the Canadian economy. The White Paper's proposals would not.

U.S. Tax Reform

Percentage Depletion Considerations

Depletion allowances determined as a percentage of mineral income are also a feature of U.S. tax legislation, and the merits of this system were recently debated at length in the United States Congress, before being left virtually unchanged.

At one point in the debate, proposals were advanced to base a portion of the total depletion allowance (in excess of a "floor" of percentage depletion) on a taxpayer's expenditures on certain exploration, development and other eligible expenditures, called for this purpose "plow back expenditures." Pertinent debate was provided on percentage depletion as related to oil and gas by the Honorable Edwin S. Cohen, Assistant Secretary of the Treasury for Tax Policy, when he appeared before the Senate Finance Committee hearings on tax reform: "I have been intrigued by this concept (plow back theory) and have had numerous discussions about it, both within the Government and outside, and I think that the argument that is made on the other side is that the incentive (percentage depletion) is intended as a reward. This is different from intangible drilling expenses, which is an actual permission to deduct the current expenses involved. But a percentage depletion is to some extent a reward.

"It changes the degree of risk of exploration because you know that if you are successful you will have tax-free benefits from it to the extent of the depletion allowance.

"Therefore, it can be argued that the incentive has been given as a reward for past action and not on the condition that this reward be plowed back into further exploration."¹

Later, in answer to a statement made by one of the committee members, he said: "I think the argument on the other side, Senator, (referring to the Senator's plow back concept) is that if your goal is to attract capital for exploration—and a lot of capital is needed for exploration in the capital-intensive industry of oil and gas—it is difficult to get the capital if the incentive is given only so long as people keep their money invested constantly in exploration. If they cannot withdraw it, if the capital is not mobile, it will be difficult to raise."

¹U.S. Senate Finance Committee, *Hearings*, September 4, 1969, pp. 703-704.

1. *Depletion—*

a. "Earned depletion" alone would not attract the capital needed to continue the development of Canada's mining industry, because it would not reduce the effective tax burden on long-term mining enterprises to levels prevailing elsewhere.

The maintenance of a "floor," or minimum level of percentage depletion, would result in corporate income taxes on mineral income more in line with the effective corporate tax rates found in such developed mining countries as Australia, South Africa and the United States and in the newly emerging nations that are developing their mining resources.

b. The burden of provincial mining income taxes must be taken into account in assessing the total income tax burden on the industry. Logically, the most appropriate means of recognizing the existence of heavy provincial taxes on the mining industry might be to have the federal and provincial governments grant a credit against their corporate income taxes for all provincial mining income taxes, as is generally done at present in the case of provincial logging taxes. To avoid difficult problems related to federal-provincial fiscal adjustments, however, Inco suggests that an acceptable solution would be to recognize the imposition of provincial mining taxes by allowing an adequate measure of percentage depletion. It is understood that, historically, the existence of provincial mining taxes was one of the reasons used to justify the introduction of the depletion allowance into Canadian income tax law.

c. Continuation of a significant level of percentage depletion would reduce the deleterious effect of the earned depletion proposals on existing mines. Percentage depletion would also overcome a severe defect in the Government's proposals, which deny any form of allowance on eligible expenditures that were made prior to November 7, 1969. For example, it is unlikely that the potash mines in Saskatchewan would benefit in any substantial way from earned depletion under the Government's proposals since no exploration or development work can be expected in the foreseeable future. Taxpayers with mineral investments may quite logically question changes that could so drastically alter the net rate of return on their investments, and become reluctant to invest.

d. Under Inco's proposal, a 20 per cent depletion allowance would be calculated on production profits before deducting exploration and development expenditures. This proposal would eliminate the inefficiency in the present depletion allowance whereby the more exploration and development a company performs, the lower its depletion allowance. Inco's proposed percentage depletion allowance, together with its proposed earned depletion provision would be limited, however, to a maximum equal to the present depletion allowance of 33⅓ per cent of net production profits.

e. Inco considers that if the incentive aspect of the earned depletion allowance is to act as a real stimulant, it must extend equally to all risk capital invested in the total mining complex. The eligible

expenditure base for earned depletion should be expanded to include all capital expenditures for mining and processing, including all mine development costs. The exclusion of such costs as underground exploration and development in existing workings, the construction and expansion of refineries, and the modernization of mining and processing equipment from the "eligible expenditures" used to "earn" depletion would mean that the largest part of a mining company's commitment of risk capital would not qualify for the incentive. To provide an incentive for only a very limited category of expenditures could result in a distortion of mining development and expenditure patterns. In particular, the extension of "eligible expenditures" to include all capital expenditures to establish or expand processing facilities would complement provincial policies, which are designed to encourage mining companies to increase their degree of processing in Canada. (See Appendix E for a further discussion of the appropriate definition of the base for eligible expenditures.)

U.S. Tax Reform Qualified Plow Back Expenditures

The concept of "eligible expenditures" debated but eventually rejected in the United States was quite comprehensive. It was defined as follows: "... the term 'qualified plow back expenditures' means all costs, including fees, wages, and salaries, incurred by the taxpayer (or members of an affiliated group filing a consolidated return) in connection with exploration, acquisition, and development of mineral properties of a like or geologically related kind to that for which the percentage depletion has been allowed, including intangible drilling and development costs, plants and facilities for drilling, mining, and producing such minerals to a readily marketable state, and research and development on methods of discovery and recovery of such minerals."¹

The concept of "qualified plow back expenditures" was to provide an "earned depletion allowance" in addition to the continuation of a "floor" of percentage depletion allowances.

¹Defeated amendment to U.S. Tax Reform Act, H.R. 13270.

2. *New Mines Exemption*—The Company strongly urges that the three-year exemption be continued for new mines in undeveloped areas. The Government's proposal to allow new mine assets to be written off without limit against income from the mine is inadequate. Since the proposal would provide only a limited deferral of tax, the real incentive to attract mining capital into pioneer mining territories would be lost. Inco suggests that its proposed incentive only be available in areas of Canada where mining has not reached a mature stage of development. Specifically, Inco feels that existing mining communities in the Sudbury District would no longer qualify for new mine status.

Inco also suggests that the total amount of exempt income from a new mine be limited to the lesser of the first three years' income from a new mine, or the taxpayer's total investment in the new mine complex.

The designation of "new mine" areas should be of sufficient stabil-

ity to enable extensive exploration programs within specific areas to reach the development stage. The actual details of the areas to which the new mines exemption in Canada would apply would be a matter of consultation between the various federal agencies and the provincial governments in the same way the federal regional expansion areas are designated.

D. IMPACT OF THE WHITE PAPER'S PROPOSALS ON INCO

1. *Inco's Operations During the 1960's*—Assuming that the White Paper's proposals had been fully implemented on January 1, 1960, Table 4 below reflects a detailed study made to give a picture of the effect of the proposed changes on Inco's operations.

The Table shows that over the ten-year period beginning in 1960 under the White Paper's proposals the Company's tax payments would have increased by \$240 million—over 74 per cent.

TABLE 4

ADDITIONAL TAX COST AND ITS EFFECT ON EARNINGS ASSUMING WHITE PAPER PROPOSALS HAD BEEN FULLY IMPLEMENTED ON JANUARY 1, 1960 1960-1969 (Thousands of dollars)

ADVERSE PROPOSALS	
1. Reduction in depletion allowance	\$194,780
2. Withdrawal of the three-year exemption for new mines	112,405
3. Other, principally taxation of capital gains	1,621
	<hr/> 308,806
FAVORABLE PROPOSALS	6,511
INCREASE IN RECORDED TAX PROVISION	<hr/> \$302,295
LESS—ADJUSTMENTS RELATING TO DEFERRED INCOME TAX	
1. Faster write-off of new mine assets	\$ 5,843
2. Tax effects of timing differences between accounting and taxable income (primarily depreciation)	54,137
3. Other items	<hr/> 1,362
	<hr/> 61,342
INCREASE IN CURRENT TAX PAYMENTS	<hr/> \$240,953
PERCENTAGE INCREASE IN TAX PAYMENTS.	<hr/> <hr/> 74 ⁰⁰ / ₁₀₀

NET EARNINGS would have been reduced an average of \$30 million annually. The average decline in earnings would have been 25 per cent and as high as 38 per cent in a given year.

While the Table reflects the magnitude of the increase in taxes and the decrease in net earnings that Inco would face under the White Paper, it is necessarily hypothetical. Faced with such a substantial deterioration in profitability and in the cash resources generated, the Company would have had to seriously re-evaluate every project in its Canadian capital expenditure program in the 1960's. This would have inevitably forced a significantly different and obviously reduced program from that which actually occurred. This considerably smaller program would have meant fewer employment opportunities, re-

duced stimulus to secondary industries, reduced exports, a reduced contribution to regional development, and a resultant narrower provincial and federal tax base. It would also have forced the diversion of a larger proportion of the Company's exploration efforts into foreign countries and provided an increased stimulus for the Company to have given higher priority than it did in accelerating the development of new projects in a number of foreign countries.

2. Impact of the White Paper's Proposals on Inco's More than \$1 Billion Canadian Expansion Program—The Company is currently in the middle of a huge investment program designed to sustain and increase its production in Canada. This program will increase Inco's Canadian nickel production by more than 30 per cent to 600 million pounds a year. The program, begun in the mid-1960's, will reach its major objectives in 1972. It will raise employment in the Company's Canadian operations by some 7,500 employees. It fulfills the stated provincial objective of maximizing the local processing of ores. It represents a significant contribution to regional development. It provides stimulus to secondary industry. It represents an investment of \$300 million in Manitoba and nearly \$1 billion in Ontario. This is more than the Company has spent for capital investment in all of the previous years of its existence.

A study of the effect of the fully implemented White Paper's proposals on this program shows that the annual earnings attributable to it would be reduced by about 27 per cent. Such a reduction of profitability would have demanded a different and greatly reduced program. A careful estimate of what this might have been follows in Section 5a.

3. Impact on Inco's Operations 1970-79 Assuming the White Paper's Proposals Were Fully Implemented in 1970—A study was made of the tax impact of the White Paper's proposals on Inco in the coming decade, assuming that the Company would complete its large expansion program and move forward on further projects it now has in the planning stage.⁷ The results of the study show that its increased tax payments for the decade under fully implemented White Paper proposals would have been 60 per cent higher than under existing tax legislation. Faced with an increase of this magnitude, the Company would obviously have to revise its plans. An outline of the revisions involved and Inco's probable future course under White Paper taxation is covered in Section 5b.

4. Comparisons of Fully Implemented White Paper Proposals Versus Various Foreign Tax Systems—What follows is not a general comparison of the White Paper's tax proposals with certain foreign tax systems, but rather comparisons of specific Inco situations. They not only show specifically how the White Paper's tax impact would

⁷It has been assumed for purposes of this calculation that the Company would have proceeded with its expansion program as presently planned. It has also been assumed that present before-tax unit profit margins would decline as the additional labor and other production costs forecast through mid-1972 were absorbed, but that the unit profit margins would then be maintained for the balance of the ten-year period and that the Company would not discover and develop any new mines other than those forecast for development in the present operating plan.

differ from that of the tax programs of other countries, but point up the competitive disadvantages that the White Paper's proposals would place on Canadian nickel deposits and on Inco's Canadian mining operations. This would not be significant if Canada had a monopoly of the world's nickel ore or if it had a body of investors, both domestic and foreign, who were interested exclusively in investing in Canadian nickel mining companies. Neither, of course, is the case.

a. Tax Impact on Inco's Coleman Mine If It Were Located in the United States Rather Than in Ontario:

Comparisons of Canadian taxes and U.S. taxes with respect to Inco's new Coleman mine, presently under development near Sudbury, have been made by assuming that all pertinent data such as investment required, sales values, production costs and other expenses would remain constant if the mine had happened to be located in the United States.

The comparison shows that the income taxes payable over the estimated life of the Coleman mine under the White Paper's proposals would be 55 per cent more than in the U.S.

On the assumption that Coleman would not qualify for "new mine" status (which it would not under Inco's proposals), the Canadian income tax burden on the Coleman mine under existing tax rules would be somewhat higher than that in the United States.

b. Inco's Income Tax Position Were It Taxed Under United States or Australian Tax Laws:

A calculation has been made for the next ten-year period of the relative tax burdens that would result if all of Inco's integrated Canadian mining operations were located in Australia or the United States.⁸ This calculation shows that with the White Paper's system fully implemented, the ten-year income tax burden in Canada would be approximately 30 per cent greater than in Australia and approximately 50 per cent greater than in the United States. Under the existing Canadian tax system the tax burden would be somewhat less than that of Australia and slightly more than that of the United States.

c. Impact of a Canadian Investment Versus a Foreign Investment:

In order to provide a specific measure of the effect of the White Paper's proposals on Canada's competitive position in mining, Inco has grouped together four of the Company's six new mines presently under development in Ontario and compared their profitability with a foreign project that Inco now has under consideration. The four Ontario mines were selected because the value of their annual production will be roughly equivalent to that of the foreign project, which is located in a stable jurisdiction.

Under comparable investment considerations (no infrastructure costs have been included in either case), the return on investment from the foreign project would be some 39 per cent greater than the return on investment from the four Ontario mines under the White

⁸See footnote 7, *supra*.

Paper's rules. Under existing Canadian tax rules the rate of return on the foreign project would be some 18 per cent greater.

While the foreign project in question does involve considerable spending on supporting facilities, the comparison as noted above is in fact the comparison that Inco or others would be faced with in the 1970's after the initial infrastructure has been provided in the foreign country.

5. Implications for Inco Flowing from the Large Adverse Impact of the White Paper's Proposals—

a. Inco's More Than \$1 Billion Expansion Program:

As a practical matter, the effect of the implementation of the White Paper's proposals on the Company's more than \$1 billion expansion program would be relatively small. The program is too far along. While certain future elements of the program could and would be deferred or eliminated, the bulk of its elements are committed and construction is already in progress or completed. The program was started before the release of the Carter Commission Report and has been pushed forward based on the belief that while the long-standing tax incentives applicable to it might be modified, they would not be radically altered or removed.

It is significant in judging the merits of the White Paper's proposals, however, to analyze carefully what the effects would have been on the Company's more than \$1 billion expansion program if the White Paper's proposals had been in effect when the program was being initiated. While precision is not possible in such an analysis, what follows is the Company's best estimate.

With an increased tax burden of such magnitude forced upon it, the Company would not only have been faced with lower profitability on individual projects within such a large expansion program, but would also have had much less internal cash to finance the program. Additionally, the reduced earnings as a result of the higher taxes would have made external financing more difficult and would have lessened the attractiveness of undertaking certain elements of the program. Under these circumstances, our analysis shows the following with respect to the expansion program:

- (1) The development of the Shebandowan mine-and-mill project near Thunder Bay, Ontario, would not have been undertaken.
- (2) It is highly unlikely that the Company would have expanded the existing Stobie mine in the Sudbury area, and it would not have developed the Kirkwood and Little Stobie mines near Sudbury.
- (3) In the Thompson, Manitoba area, while the development of the Birchtree mine would have gone forward, it is highly unlikely that the development of either the Soab mine or the large Pipe mine complex, both now under way, would have been undertaken.
- (4) These decisions would have meant a very substantial reduction in our projected increase in ore production and, therefore, the related need for expanded surface facilities would have been

sharply reduced. Such projects as the new Clarabelle mill, the new Copper Cliff refinery based on Inco's pressure carbonyl process, and the expansion of the iron ore recovery plant and of the copper refinery in the Sudbury area would not have been undertaken. For the Thompson area, while certain surface processing facilities would have had to be modestly expanded, they would not have had to be doubled for the increased Manitoba production, as is now the case. Overall, our best analysis indicates that in the seven-year period ending in 1972, our capital expenditure program would have been reduced by \$500 million. This would have resulted in a production level of less than 500 million pounds of nickel a year rather than 600 million a year. Copper production would also have been substantially reduced.

b. Inco's Future Development and Expansion in Canada:

If the Company were faced today with the full implementation of the White Paper's proposals with their severe effect on the profitability of its operations, the following is our best estimate of the actions Inco would be forced to take:

- (1) The Company would indefinitely defer the development of the following mines in the Sudbury area, which are now under active consideration: Cryderman, Blezard and Whistle. In addition the extensive exploration program of the North Range area, which the Company is hopeful will lead to an additional mine would be curtailed.
- (2) In Manitoba, Inco would be forced to indefinitely defer the program now under way to continue the exploration and development of the 100-mile Moak Setting Belt and thus jeopardize the future development of Mystery Lake, Moak Lake and other deposits.
- (3) In both the Sudbury and Thompson areas certain important surface facilities related to these mines would also have to be deferred.
- (4) Of long-term significance would be the inevitable decision to divert an appreciably higher percentage of the Company's large exploration program to foreign countries. It has long been a deliberate Company policy to spend the great bulk of its exploration budget at home. A major shift in this policy would very materially hasten the day when Canada's prominent position in world nickel production would be diminished.

6. *Conclusion*—The White Paper's proposals, if implemented, would dictate a specific reduction in the Company's Canadian expansion and development programs. But in broader terms, the White Paper's proposals would force a relatively static posture on the Company's Canadian operations. Inco would continue to mine and process its existing ore bodies. It could perhaps expand its Canadian production modestly. It would only be able to replenish its ore reserves where it could find deposits that could stand the very heavy taxation burden. But the high taxes would prevent large tonnages of low-grade deposits from

ever being mined, tonnages which are the basis of Inco's current and future Canadian development programs. The inevitable effect would be to shorten the future life of Inco's operations and those of other mining companies in Canada.

It has been argued that increases in price could be used to compensate for the higher tax burden—and this is tempting, particularly so in a period of nickel shortage, when higher prices probably could be obtained on a short-term basis. This argument, however, ignores three fundamental realities:

First, that mining investments must be looked at on a long-term basis and involve large and permanent commitments of capital.

Second, that nickel in its various ultimate uses must compete with other materials for markets. This competition is relentless and strong, and while nickel-containing products have been successful in some markets, they have lost out in others, and usually because of their cost.

Third, the fact that 80 per cent of the world's known nickel reserves are outside of Canada. This was not always the case. It is today, and has come about largely because of the advances in the technologies used in processing lateritic ores. Canadian nickel ores are in direct competition with these foreign reserves. An excessive tax burden, far higher than the taxes being applied to the vast non-Canadian nickel ore reserves, means that Canada's lower-grade ores cannot be economically developed.

While Inco's planning has called for developing properties in foreign countries, it has also planned to continue to explore and develop properties here. The effect of the White Paper's proposals, if they become law, would be to substantially eliminate its development of the Canadian component of this program. This would mean that Inco's Canadian operations would tend to become static. Projects like its vast Thompson development in the late 1950's or its current program to develop Shebandowan ores, or to heavily explore the North Range in the Sudbury area, all entail serious risks. These risks involve large long-term commitments and judgments on many intangible factors that cannot be quantified.

The underlying force that has encouraged the Company to accept these risks has been this country's reputation for providing a good investment climate. The largest single factor with respect to resource industries has been the long-standing, predictable tax incentive program.

If enacted, the White Paper's proposals, involving an increase in the taxation of the mining industries not just of a modest degree but of a most substantial nature, would effectively eliminate Canada's reputation for providing a favorable investment environment for mining.

When this is combined with the growing competition from foreign ore bodies, the result can only be substantially smaller investment in, and development of, the country's mineral resources. The effect on the country's economic growth and the welfare of its citizens would be substantial.

III. International Operations

A. THE GOVERNMENT'S POSITION ON TREATMENT OF FOREIGN INCOME

The White Paper recognizes Canada's interest in an unrestricted flow of international capital. The principal proposals in this area are:

1. *Dividends from Controlled Foreign Corporations*—The Government proposes that the present exemption for dividends received from a controlled foreign corporation be restricted to dividends from a country with which Canada has concluded a tax treaty.

Dividends received from a foreign subsidiary in a non-treaty country would be fully taxed when received in Canada, with credit allowed for underlying foreign taxes.

2. *Passive Income*—To counter abuses that artificially divert income to tax havens, the Government proposes to impute income of this nature—classified as “passive income”—to the Canadian shareholder of foreign subsidiaries as such income is earned. The Government has indicated that it intends to pattern its proposals after Subpart F of the U.S. Internal Revenue Code, but the details and scope have not been spelled out.

B. INCO'S ANALYSIS OF THE GOVERNMENT'S PROPOSALS

1. *Dividends from Controlled Foreign Corporations*—

a. It is difficult to understand why the existence or non-existence of a tax treaty should determine whether dividends received by a Canadian parent company should be subject to tax in Canada. Under the Government's proposals, dividends from countries (such as Ireland) with which Canada has tax treaties and which have a high level of tax incentives would not be subject to Canadian tax. On the other hand, dividends from a developing country with which Canada has no tax treaty but that offers a similar high level of tax incentives would be subject to Canadian tax. Developing countries are reluctant to enter into tax treaties because they believe there is little benefit to be derived from them. Such countries are short of capital, and are not interested in facilitating investments by their citizens in Canada. Despite intensive efforts, the United States, a nation with massive foreign investments, has only one tax treaty in effect with a developing country. (See Appendix F, where the extreme difficulties of negotiating treaties with developing countries are discussed). Foreign countries have only an

indirect interest in how Canada taxes income originating from within such countries, and they cannot be expected to enter into a tax treaty with Canada merely to allow Canadian investors some reduction in Canadian taxes. Inco questions whether distinctions in the taxation of income flows into Canada on the basis of country of origin have much effect as bargaining points in the negotiation of tax treaties.

b. The White Paper's proposals, as they stand, would encourage Canadian companies to make their foreign investments in developed countries and avoid investments in developing countries that have a great need for capital inflows.

Furthermore, tax incentives are frequently offered by developing countries to companies of all nations to attract foreign capital. These incentives are usually of general applicability and provide tax incentives for the development of both manufacturing and resource industries. The incentives become meaningless if they do not benefit the investor, but are instead offset by the tax laws of the investor's country. Once aware of the effect of the proposed "no treaty" provisions, the developing country would in turn increase its tax rate to "sponge up" any additional tax that would otherwise be paid to Canada, thus diminishing dividend repatriation.

c. Canadian companies would be placed at a distinct disadvantage with their non-Canadian competitors.¹ As indicated in the introduction to this Submission, the productive nickel-bearing deposits of the world are no longer the sole possession of Canada. Many of these deposits are in the new developing countries with whom Canada has no treaties at present and is not likely to have in the foreseeable future.

d. Many aspects of the White Paper's proposed system of taxing international income are incompatible with established international tax practices, and there would likely be interminable delays in negotiating treaties even with those countries that are prepared to sign them with Canada. (For a detailed analysis of the effects of the Government's bilateral tax treaty proposals on dividends from developing countries, see Appendix F.)

e. The taxation of dividends from non-treaty countries is likely to result in substantial additional tax costs to Canadian companies receiving them in two cases: (1) dividends received from investments in non-treaty countries where the host country has extended substantial tax incentives for investment; and (2) dividends from "tax haven" operations. The taxation of dividends in the first case would be a backward step and would inhibit Canadian investment

¹The U.S. tax system contains a "gross-up and credit" approach to the taxation of dividends received by U.S. companies from foreign affiliates along the same general lines as proposed by the White Paper for the taxation of dividends received by Canadian companies from affiliates in non-treaty countries. The U.S. system contains many alleviating features, however, including an overall foreign tax credit election and the right to consolidate foreign earnings for tax credit purposes, which can result in a substantial modification of the U.S. provisions. There is no indication that these relief provisions would be available under the Canadian proposals.

in the countries that need it. The taxation of dividends in the second case is unnecessary in view of the proposals for the taxation of passive foreign income.

2. *Passive Income*—The Government's passive income proposals, evidently to be patterned on Subpart F of the U.S. Internal Revenue Code,² are designed to prevent Canadian companies from avoiding taxes on investment income and artificially diverted profit. Inco understands that a number of Canadian companies are using subsidiaries situated abroad in low-tax jurisdictions as a means of facilitating their exports of Canadian-manufactured products. At present, because of such arrangements, profits on export sales reasonably attributable to marketing and distribution functions actually carried on outside of Canada may be subject to lower effective rates of tax.

Under the White Paper's proposals, it seems likely that all such export profits would be considered as "passive income" and subject to full Canadian taxes. This would diminish the ability of Canadian companies to penetrate foreign markets and increase exports of Canadian products.

A number of other countries have provided a variety of tax incentives for their exporters. Under international rules, Canada would find it difficult to directly rebate corporation taxes applied to the export profits of Canadian companies, even though other countries deriving an important part of their tax revenues from sales taxes are allowed to rebate imposts on such exports. Allowing some tax advantage to be gained by Canadian exporters through exempting from passive income provisions a reasonable portion of export profits earned abroad would make Canadian companies more competitive in world trade. Inco observes that the United States already provides some corporation income tax incentives on export sales through its Western Hemisphere Trade Corporation provisions, and is considering extending such incentives to a whole new class of export companies.³

For similar reasons, Inco believes it would be in Canada's interest to refrain from imposing passive income tax penalties on interest and royalties received by one foreign subsidiary of a Canadian company from another foreign subsidiary engaged in active business abroad. Such payments are employed by many international corporations as a means of legally minimizing foreign taxes.

Inco notes that the present U.S. Subpart F legislation is part of a tax

²The United States tax system has proved to be extremely complex, so much so that The Honorable Edwin S. Cohen, Assistant Secretary of the Treasury for Tax Policy, in a speech on November 19, 1969, stated that a basic consideration for reform is that the "present law is far too complex. It is too complex for taxpayers and too complex for efficient administration. . . . The cost of complexity both to taxpayers and the Government in this area is real, stemming largely from the necessity to assign large numbers of very intelligent people in an effort to make the present mechanism function. I think we should strive to shift some of this talented manpower both inside and outside of government away from such intricacies as Subpart F income . . . to work creatively on such critical needs as low income housing, transportation, legal services for the poor, and other frontiers of the law."

³The U.S. Treasury Department has recommended that "Domestic International Sales Corporations" (DISC) be granted indefinite tax deferrals on income from their export activities until such income is remitted to the U.S. parent company.

system that makes extensive use of foreign tax credits, and contains a number of important relief provisions, including:

- a. The minimum distribution provision whereby Subpart F income is eliminated if the controlled foreign corporation makes a sufficient minimum distribution. Such minimum distribution may be determined by grouping foreign subsidiaries together, by offsetting deficits in one subsidiary against profits from another, and by taking into account the tax burden in a controlled foreign corporation through an extensive foreign tax credit system.
- b. The "30-70" rule whereby attribution of income is avoided if the prescribed income does not exceed 30 per cent of the controlled foreign corporation's total gross income.
- c. The "passive income" label does not apply to dividends and interest received from corporations in developing countries if the income is reinvested in such countries.

If the Canadian tax rules relating to foreign passive income do not contain similar relief provisions, they will be substantially more onerous than the U.S. rules and would inhibit the foreign operations of Canadian companies.

C. INCO'S ALTERNATIVE PROPOSALS

1. Dividends from Controlled Foreign Corporations—The Company recommends that Canadian companies should continue to receive dividends from their controlled foreign subsidiaries exempt from Canadian tax, regardless of whether or not the foreign subsidiary is in a country that has a tax treaty with Canada.

2. Passive Income—It is not possible for Inco to offer any specific comment on the Government's proposals to tax foreign passive income until the details are released. Inco believes that existing tax laws should be used to prevent the diversion of what would otherwise be Canadian-source income to tax havens; if necessary, additional laws should be enacted for this purpose, but the definition of passive income should not be so broad that legitimate offshore operations are arbitrarily and unfairly taxed by Canada.

The reasons for Inco's recommendation that the present dividend exemption be retained are as follows:

1. The most compelling reason for continuing full exemption for dividends from foreign subsidiaries is to sustain Canada's competitive position in foreign markets and in areas where foreign competition is intensifying. Continuing this exemption would recognize an internationally accepted practice, i.e., that the burden of corporate tax applicable to a corporation's operations should be primarily determined by the rules of the country in which its business is undertaken and in whose competitive environment it operates.⁴ Of course, the country from which the investor's capital is drawn should be entitled to tax the distributions out of such profits to individual shareholders.

⁴See Appendix F for a discussion of the advantages and disadvantages of alternative methods of taxing foreign-source income.

2. The full exemption provision eliminates discrimination against Canadian investment capital moving into developing countries. This is important for Canadian mining companies who need to retain their competitive position with respect to foreign mining companies. In addition, the mining expertise built up in Canada over many years is extremely useful to the economies of the developing countries and should not be denied to them.
3. The full exemption for foreign dividends is a simple and useful part of the present Income Tax Act. It should be continued, but with appropriate safeguards to prevent the diversion of what would otherwise be Canadian-source income to tax havens. The foreign tax credit concept proposed for non-treaty dividends is very complicated to administer and would be unfair when applied to income from foreign countries that raise a high proportion of their required revenue by means of a form of tax—such as a sales or export tax—that does not give rise to a foreign tax credit.⁵
4. The full exemption of foreign dividends would induce Canadian companies to continue to repatriate foreign earnings, and would remove the disincentive against investing those earnings in Canada.

International Expansion:
Canada versus the United States

Inco has computed the overall tax on a substantial foreign project it has under consideration assuming that the operating subsidiary is owned by a Canadian parent and, alternatively, by a U.S. parent. It has computed the tax to the Canadian parent both under the present tax rules and under the White Paper's proposals. It has also been assumed that a U.S. parent would operate the project through a U.S. subsidiary.

The comparison shows that, over the estimated project life, the total tax burden to the Canadian parent under existing Canadian tax rules would be almost identical to the taxes borne by a U.S. parent owning the same project.

If, however, the White Paper's proposals regarding taxation of passive income and dividends from non-treaty countries were applied, the Canadian parent's tax burden would increase by 38 per cent.

⁵In New Caledonia, for example, resource companies are taxed primarily under a system of export duties for which no Canadian foreign tax credit would evidently be available.

IV. Corporations and Their Shareholders

A. THE GOVERNMENT'S POSITION ON TAXING SHAREHOLDERS

The Government proposes that the shareholders of “closely held” companies should receive full credit for the corporate income taxes paid by their companies. Shareholders of “widely held” corporations would, on the other hand, be entitled to credit for only one-half of the applicable Canadian corporate tax paid by such companies. Simply stated, the Government’s proposals would substitute a dividend tax credit related to the amount of corporate tax paid for the present dividend tax credit related to the amount of dividends received.

The Government argues that the present dividend tax credit system has the following deficiencies:

1. The present dividend tax credit is worth more to high marginal tax rate shareholders than it is to low marginal tax rate shareholders. In other words, the present dividend tax credit results in a less highly progressive tax on dividends than on earned income.
2. The dividend tax credit is allowed in circumstances where the corporate income in question has not borne Canadian income tax as, for example, when it is derived from foreign profits or from income subject to mining incentives.
3. The proposed dividend tax credit would be more effective in encouraging Canadians to buy the shares of Canadian corporations than the present dividend tax credit.

B. INCO'S ANALYSIS OF THE GOVERNMENT'S PROPOSALS

Inco believes that the radical and complex changes suggested for the taxation of corporate source income would have a number of detrimental effects on our economy and business environment. Appendix G sets out in some detail certain of the problems that the proposals would create. The more important objections are as follows:

1. *Discrimination Against Growth*—The proposed system of integration would discriminate against growth companies and resource companies. Incentives are built into the corporate tax system to encourage specific economic goals. Examples of such incentives are accelerated capital cost allowances, depletion, tax holidays and direct write-offs of capital acquisitions. The Government recognizes that such incentives are necessary to stimulate activity at the corporate

level. Yet, under the White Paper's proposals, they would be taxed away when distributed to shareholders, thereby sharply reducing their effectiveness. For example, a mining company that could eliminate its mining income through the use of the proposed unlimited write-off of new mine assets would find that dividends to shareholders would not carry creditable tax, with the result that full marginal tax rates would apply.

2. *Reduced Attractiveness of Resource Shares*—Distributions out of earnings that have not been taxed at the corporate level because of resource industry tax incentives would not carry creditable tax. Therefore, the value of resource company shares to Canadians would decrease. On the other hand, the tax position of the non-resident who owns shares in a Canadian resource company would not change. This would mean that the shares of Canadian companies that have a high proportion of incentive income, such as mining companies, would, because of their lack of "creditable tax," decline in value in the Canadian market relative to the shares of other Canadian companies. Because of this, mining companies would become a relatively more attractive investment to non-residents, resulting in an increasing proportion of Canada's natural resources falling under foreign control. For similar reasons the shares of other high growth-rate companies would also become more attractive to non-residents.

3. *Unattractiveness for Foreign Expansion*—The financial benefits of integration are restricted to Canadian source income. Corporations expanding into foreign areas would find that foreign dividends that flow through to Canadian shareholders would carry little creditable tax. This would tend to discourage Canadian companies from developing foreign markets. Also, Canadian companies with substantial foreign income would become less attractive to Canadian shareholders because such companies would lack creditable tax.

4. *Complications for Inter-Corporate Dividends*—The proposed method of taxing inter-corporate dividends would inhibit corporate investments, especially where incentives or deferrals such as accelerated capital cost allowances have applied to source company profits. The present free flow of inter-corporate dividends between Canadian companies has kept the system simple. The adoption of the proposed system would create enormous difficulties in inter-corporate management arrangements and cash flows.

5. *Compliance Difficulties*—The criteria for the distinction between closely held and widely held companies are open to serious question as to their realism and workability. Compliance costs, record-keeping, administration, and other complexities would escalate for both taxpayers and governments. The availability of creditable tax combined with the two-and-one-half-year "staledating" rule would unduly interfere with dividend-setting policies.

C. INCO'S ALTERNATIVE PROPOSALS

For the reasons noted above, the Company opposes the concept of tying the tax credit on dividends to the tax paid by the corporation. Instead,

Inco proposes either (1) the continuation of the present dividend tax credit system but at a rate of, say, 25 per cent, with—if the Government thinks advisable—revisions therein to make dividend taxation more progressive, or (2) the adoption of a gross-up and credit mechanism at a rate of, say, 40 per cent, applied uniformly to all dividends without reference to the actual corporate tax paid. In addition, the Company urges that the present system of tax-free inter-corporate distributions be retained, supplemented by a “partnership option” election to provide an effective form of consolidation of corporate incomes.

The following comments provide an explanation of Inco’s proposals:

1. Either of Inco’s proposals would treat all Canadian companies alike and thus avoid the difficulties and unfairness of the Government’s proposals. In addition, Inco’s proposals would retain a system that is understandable both for shareholders and corporate managers alike and is compatible with the self-assessing system.
2. If the present dividend tax credit system is retained, the credit could, if desired, be adjusted based upon marginal tax rates of dividend recipients so that the credit would not be worth more to high marginal tax rate shareholders than to low marginal tax rate shareholders.
3. Under Inco’s gross-up and credit proposal, all dividends received by Canadian shareholders from Canadian companies would be grossed-up by approximately 40 per cent, and this amount would be deducted from the shareholders’ tax liability. For example, a dividend of \$1.00 would be included in income at \$1.40, taxed at the marginal rate of the shareholder, with 40 cents deducted from tax as a credit.
4. Under either of Inco’s proposals, the benefits of the various economic incentives to achieve national objectives would still flow through and be retained by the shareholders. To encourage a particular goal through incentives on the one hand and then tax them away on the other makes the incentives ineffective.
5. Canadian companies should be encouraged to create viable foreign operations and markets, and this should not be discouraged at the shareholder level. Either of Inco’s proposals would encourage Canadians to invest in Canadian equities, but unlike the Government’s proposals would not discourage Canadian companies from developing foreign markets.
6. Inco appreciates that under either of its proposals it would be necessary to have restrictions on the deduction of capital losses to prevent abuses in the removal of corporate surpluses. Because of the limited time available, Inco has not attempted to devise such restrictions but it is convinced that appropriate rules could be developed.
7. The partnership election would be a step toward consolidated tax returns for corporate families. This election would remove in large measure present corporate difficulties of income and expense allocations between companies.

V. Other Considerations

A. EFFECTS ON EMPLOYEES

There are several aspects of the reform proposals affecting individuals that would have a serious effect upon Canada's efforts to attract and retain competent and skilled personnel.

The most adverse aspects of the proposals upon employee retention and mobility are the following:

1. *Canadian-U.S. Tax Disparity*—The new tax rate schedules would increase the impact of personal income taxation on persons with incomes in the \$10,000 to \$30,000 range. Canada must look to this group for skilled technical and managerial personnel to satisfy the increasing manpower requirements of its expanding industries and commerce. The reform proposals would greatly increase the already existing personal income tax disparity between Canada and the United States, further handicapping Canadian efforts to attract skilled persons from abroad, and possibly contributing to the emigration of skilled workers from Canada. The extensive tax disparities between representative Canadian employees and their U.S. counterparts are set out in Appendix D.
2. *Employee Mobility Restricted*—The proposals for deemed realization of asset gains of persons giving up Canadian residence also represent a serious obstacle to attracting staff for work in Canada and to staff mobility within the sphere of international operations. The problem would be particularly severe in its effect on the decisions of non-residents who may wish to locate in Canada. Canadian residents may also be seriously deterred from accepting transfers abroad.
3. *Higher Tax on Employee Benefits*—The proposals also further increase the tax disparity between the United States and Canada by eliminating the present Income Tax Act averaging provisions for employee benefit programs, such as stock options, in favor of a new and totally inadequate income averaging formula.

International Nickel regards the above-mentioned deficiencies in the Government's proposals as being inimical to the best interests of this Company and its employees and therefore respectfully submits the following proposals:

1. The proposed tax rate schedule, particularly as it applies to individuals in the \$10,000 to \$30,000 range, should be revised so as to lessen—as far as practicable—the tax disparity that would exist be-

tween Canadian and U.S. employees.

2. The deemed realization proposals applying to departing residents should be eliminated.

3. The proposed income averaging formula should be revised, perhaps along the lines suggested by The Royal Commission on Taxation. This is of vital importance to employees who presently are entitled to participate in stock option and other employee benefit programs.

It is the opinion of this Company that the adoption of its suggestions set forth above would make a positive contribution for acquiring, transferring and retaining the management and technical skills that Canada so urgently requires. The Government's proposals would inhibit the free movement in and out of Canada of employees of international companies. The Company's proposals would encourage skilled persons from abroad to work for Canadian firms and would allow Canadian residents to go abroad and contribute to the worldwide development of Canadian international projects.

B. CAPITAL GAINS

1. *Rate of Tax*—In its examination and assessment of the Carter Commission Report submitted to the Minister of Finance in September 1967, Inco recommended acceptance of the concept that capital gains should be taxed, but opposed the proposed taxation of capital gains at full income tax rates "... because it would reduce incentives, discourage risk taking, reduce capital accumulation, and thus inhibit growth."¹ The reasons why capital gains should not be taxed at full rates are as compelling today as they were in 1967.

Inco is of the view that only 50 per cent of a capital gain should be taxed on the disposition of assets and 50 per cent of the loss should be deductible. If top individual marginal rates are reduced to 50 per cent, the effect of Inco's proposal would be to tax capital gains at a top marginal rate of 25 per cent. Only gains on assets held for an appropriate period of time would be eligible for this recommended tax treatment. Inco would, with safeguards to prevent abuses, exclude from taxation the gains from the sale of principal residences and personal property. Inco is opposed to the proposed five-year deemed realization tax on the shares of widely held companies.

2. *Rollovers*—The White Paper at paragraph 3.44 proposes rollover provisions to deal with forced realizations such as expropriations and the collection of insurance proceeds or damage claims in connection with destruction of an asset. The proposed provisions contemplate that, if the taxpayer uses the whole of the proceeds to purchase similar property within a year of the receipt of the proceeds, a gain which would otherwise be taxable would be treated as a reduction in the cost to him of the new property. The Company does not think the period of one year is sufficient in length in the case of, for example, the destruction of a large plant. The time involved in possibly selecting

¹Inco's submission on the Carter Report, p. 10-1.

a new site, planning and designing a new plant, etc., could be several years. Inco proposes, therefore, that provision be made for a four-year period rather than a one-year period.

It is most important that rollover provisions be as flexible as possible, consistent with preventing tax avoidance. For example: (1) the existing rollover provisions with respect to recapture of capital cost allowance should be adapted to permit comparable rollovers for capital gains realized on the sale of capital assets; and (2) there should be provisions that would permit the transfer of assets (including mining rights) at cost between a parent company and its wholly owned subsidiaries.

C. RELIEF FOR SMALL BUSINESSES

The proposal to eliminate the low rate of corporate income tax on the first \$35,000 of income is controversial. Inco sympathizes with the difficulties the Government has had in administering these provisions and the problems of integrating the low rate of tax with the rest of the system. Inco believes, moreover, that mature companies have reached the position where the benefit received from the low rate should be transferred to new businesses who desperately need start-up assistance. Canada has a real need for new entrepreneurship in developing such a large country, and some form of incentive package should be available to beginning companies in the form of accelerated depreciation and deferral of tax payments.

D. SHAREHOLDER DEPLETION

The proposal to eliminate shareholders' depletion is unfair to Canadian shareholders who have taken the allowance into consideration in their decision to acquire their shares. Also, it tends to make shares of Canadian resource companies less attractive to Canadians and more attractive to non-resident shareholders. This would work against the Government's desire to encourage greater Canadian ownership of this nation's resources.

E. BUSINESS AND PROPERTY INCOME

1. *Convention and Entertainment Expenses*—The proposal to deny all convention, entertainment and related costs seems out of focus with the other proposals in the White Paper that would allow the full deduction of all proper business costs. While Inco supports all reasonable measures to curb expense account abuses, the Company believes proper enforcement of existing rules together with specific requirements for the full substantiation of all entertainment costs would be a much more equitable solution than the Government's proposal.

2. *Deductibility of Mining Taxes*—Though provincial mining taxes are generally deductible in determining federal taxable income, the Government's proposals have not attempted to correct a present inequity in this area. Where the federal basis for calculating mining profits is less than the applicable provincial basis, a portion of the

mining tax is not deductible. This happens, for example, when capital cost allowances for federal tax purposes are greater than those allowed for provincial mining tax purposes. Inco recommends that mining taxes be fully deductible.

3. *Transferability of Earned Depletion*—It is recognized that the adoption of the earned depletion concept will present difficulty for companies acquiring other mining companies which have unused eligible expenditures, or subsidiary companies who have eligible expenditures, which cannot be utilized by the parent. Appropriate rules will be required to permit the transferability of earned depletion between companies under controlled conditions.

VI. Economic Aspects

The Government's conclusion with respect to the White Paper's economic effects are summarized as follows:

The tax reform proposals set forth in this paper are expected to have relatively modest impact upon the Canadian economy apart from the effect of savings in closely-held companies, and possibly on investment in the mining industry.

(*Proposals for Tax Reform*, paragraph 8.35.)

Inco believes that the proposed new tax system must be expected to have a substantial adverse effect not only on investment in the mineral industry but also on the potential for growth of the entire Canadian economy.

A. REVENUE EFFECTS

A first step in evaluating the economic impact of the White Paper's proposals is to consider the projected effects that it would have on Government revenues. The projections in the White Paper indicate, on the basis of 1969 incomes and prices, that the proposals would increase federal and provincial income tax revenues from the present total of \$11 billion by amounts ranging from \$165 million in the first year of the new system to \$630 million in the fifth year.¹ (Of this latter figure, \$550 million would be derived from increases in the income taxes paid by corporations.) These estimates do not include any amount for the substantial additional taxes that the White Paper proposals would impose on the mining industry; owing to complex transitional arrangements, the impact of these changes would accrue over a period of time and in any event would be difficult to predict because of the possible decline in mineral production as a result of the adverse tax changes.² The Government implies that its proposed tax changes would do little more than maintain current Government revenues, based on 1969 prices and incomes.

These estimates clearly do not provide a realistic indication of the actual revenues that the White Paper's proposals would raise when fully implemented, because all of the Government's projections have been based on 1969 incomes and prices. The growth in the national income over the next few years, the increase in incomes because of

¹*Proposals for Tax Reform*, chapter 8, Tables 15 and 16.

²In a paper presented to the Ministers of Finance meeting on February 2, 1970, the Ontario government has estimated that the adverse tax proposals affecting the mining industry might raise \$200 million annually in additional taxes when fully implemented.

inflation, and above all the effect of a progressive income tax structure would mean that not only would the White Paper's tax system collect increasing total amounts in taxes over the next decade, but it would collect an increasing percentage of the country's total income. The present personal income tax structure has a "fiscal dividend" effect of taking an increasing share each year of total personal incomes in taxes.³ As personal incomes rise because of both real gains and inflation, individuals move into higher tax brackets, with their increase in incomes being subject to the application of marginal (rather than average) tax rates. As taxable incomes are less than total incomes by an amount equal to personal exemptions and other deductions, any increase in total incomes will result in a proportionately higher increase in taxable income. Under the proposed system this effect will be sharply accentuated by the higher personal exemptions and the higher marginal rates.⁴

A Canadian economist, Professor D. J. Daly,⁵ has prepared at Inco's request a paper outlining the economic impact of the White Paper's proposals, and this paper is attached as Appendix D to this Submission. In this paper, Professor Daly makes the following observations on the revenue yields to be expected from the White Paper proposals:

1. *Revenue Buoyancy*—The revenue buoyancy (or income elasticity) of the new system is substantially higher than the existing system. Adoption of the White Paper's proposals would therefore mean that Government revenues from personal income taxation would increase at an even more rapid rate than under the present system.
2. *Sharp Revenue Increase*—The present personal income tax structure could be expected to raise more than \$8 billion in additional income taxes annually by 1975, because of the revenue buoyancy previously referred to.⁶
3. *Increased Buoyancy of New System*—The new system, when almost fully implemented in 1975, can be expected to raise substantially higher revenues than the present system.⁷
4. *Further Study Needed*—A calculation of the revenue increases under the White Paper's proposals should be made, using realistic assumptions regarding growth and price changes.

Even if Professor Daly's assumptions regarding anticipated growth and price change were modified to assume a lower rate of growth, the

³This built in "buoyancy" in present federal tax collections relative to increases in gross national product has been clearly identified in studies of tax revenues over the several past years under the present system. See Appendix D.

⁴The effect of increased personal exemptions under the White Paper is that the percentage increase in taxable incomes would exceed the increase in total incomes, and the effective rates to be applied would also be considerably higher than under the present system. This point is discussed in Appendix D.

⁵Professor of Economics, York University; formerly senior research advisor to the Economic Council of Canada.

⁶Based on assumed increases in employment, incomes and prices set out in Appendix D. These include an estimated growth rate of 5½ per cent, as predicted by the Economic Council of Canada, and an assumed average inflation factor of 4 per cent a year—somewhat lower than the actual experience of the last two years, and in line with the experience of the past five years.

⁷Personal income tax revenues, federal and provincial, for 1969 are estimated at \$7.6 billion.

conclusion is not altered that federal revenues are going to be significantly affected. If, for example, an annual growth rate of only 4 per cent and an inflation factor of 2 per cent are assumed to 1975, the expected increase in federal revenues in that year would be in excess of \$4 billion—and the additional revenue potential of the White Paper's proposals would be added to this figure.

It is unfortunate that there has been relatively little discussion of these important implications of the White Paper—implications that are vital to an understanding of the real impact that the White Paper would have on our economy. The fact that the White Paper's proposed tax rates would result—over a period of years—in an increased diversion of resources from the private to the public sector, because of the increased buoyancy of the new system, should be much more widely understood and evaluated.

It is of course clear that Government expenditures will increase over the next few years, owing to the influence of inflation and population growth. It seems likely, however, that the cost of existing Government programs will not increase as fast as the projected revenues discussed above.

The White Paper states that the proposals are designed to maintain present tax revenues, and suggests, at least implicitly, that increases in tax burdens are necessary to help pay for the desirable relief offered to lower income taxpayers through increased personal exemptions and child care deductions. The White Paper proposes to obtain these increases primarily by increasing the tax rates applicable to middle income taxpayers and by a sharp increase in effective corporation taxes. One source of increased revenue from the corporate sector would be the additional revenue that might be raised from the sharp cutback in mining incentives.

But if, as Professor Daly points out, the revenues from the existing system will increase dramatically over the next few years—and even more so under the White Paper's proposals—it will be possible to raise necessary Government revenues without implementing the degree of tax increase proposed in the White Paper. This suggests that the existing mining incentives can be objectively evaluated on their merits.

B. MINING TAX INCENTIVES

The White Paper's proposals, unlike the Carter Report, recognize that the mining industry is subject to exceptional risks and uncertainties, and that there are special benefits to Canada by providing some level of incentives to this highly productive industry. The White Paper concludes that while support for mining is as justified as support for scientific research, such support should be provided on a basis substantially less generous than in the past.⁸ The White Paper recognizes that this reduction in incentives will have an adverse effect on Canadian mining development but states that it would not

⁸*Proposals for Tax Reform*, paragraph 5.24.

be serious. The White Paper fails to appreciate how severe this decline would be.

The Government's position reflects the view that the tax system should "ensure that really profitable projects bear a fair share of the burden of taxation."⁹ The Paper then proposes that the more important present mining incentives—the three-year exemption for the income from a new mine and percentage depletion on mining profits—should be replaced by two new incentives, the accelerated write-off of new mine assets and the earned depletion allowance, which are said to be more directly related to specific activities that the Government wishes to encourage. The White Paper fails to recognize, however, that inducements to commit funds to exploration and development require not only provisions for satisfactory write-off of costs incurred, but the continuing prospect of an acceptable rate of return on ultimate production. What constitutes a satisfactory rate of return on mining activities will necessarily be determined in relation to risks, returns, and tax levels throughout the world. In this connection, the special recognition generally given in the tax systems of other countries to the risks and uncertainties in mining is especially relevant, and cannot be ignored in determining the appropriate level of mineral taxation in Canada.¹⁰

The above quotation from the White Paper mentions the concept of a "fair share" of tax burden. Criteria for establishing "fairness" are not given in the White Paper and are of necessity highly subjective. The White Paper has apparently accepted—at least to a degree—the concept of "neutrality" as a major element of what the Government considers should constitute a "fair" tax system. The 1967 Report of the Royal Commission on Taxation supported the concept of neutrality, not only because it considered neutrality between different industries and taxpayers to represent a contribution toward the improvement of the "fairness" of the tax system, but also because it believed that the application of such a principle would lead to the optimum allocation of resources within the economy. While the White Paper has departed somewhat from the Commission's view by recognizing a case for some non-neutral treatment or incentives for the mining industry, it has sharply limited the extent of such special treatment, with consequences that have already been described in this Submission.

In Appendix D to this brief, Professor Daly has set forth a commentary on the concept of neutrality as it applies to the totality of Government policy. Professor Daly argues convincingly that total Government policy in Canada is and has been profoundly non-neutral, and that the possible benefits that could flow from an overall neutral economic policy cannot be achieved by seeking neutrality in one aspect only of that policy. In this respect, the non-neutral effects of Canadian tariffs have been particularly significant, both before and after the Kennedy Round reductions. Professor Daly puts for-

⁹Proposals for Tax Reform, paragraph 5.24.

¹⁰See Appendices B and C for the incentives offered mining in other countries.

ward the view that a consciously non-neutral tax policy (and one that may therefore not necessarily meet certain subjective standards of "fairness") may well be necessary so that the total economic policy of the Government more nearly approaches the objective of neutrality.

The important point here is that Canadian producers of raw materials and primary products, such as metals, receive virtually no tariff protection. Indeed, to a significant extent they are adversely affected by the present Canadian tariff, as it raises the price of manufactured goods consumed by such producers. Furthermore, the products of such producers must compete on world markets at world prices, which are subject to tariffs levied by other countries and to transportation costs. The prices of such primary products tend to be at or even below world prices, as compared to the products of protected Canadian manufacturers, whose prices generally tend to be above world prices.

Available data suggest that the output per person of Canadian primary industries—as opposed to Canadian manufacturing—compares favorably with that of the United States and other countries, and along with this, wage levels paid in Canadian mining are comparable to those in the United States. The Canadian mining industry has been highly efficient because it has had to be, and resources devoted to this industry represent a highly advantageous use of such resources.

In a study of the Carter Commission's proposals and their relationship to Canada's economic goals, Dr. Neil H. Jacoby, a Canadian-born economist of international reputation, summed up his views of the significance of minerals investment in Canadian economic growth as follows:

The evidence shows that extractive industries have played a strategic role in Canada's economic development, and that the minerals industries in particular will do so in the future. Primary investments in minerals exploration and development, largely by foreign investors, have had a large multiplier effect upon total investment, by inducing further outlays in refining, smelting, pipelines, railroads, water transport, construction, and secondary and tertiary producer and consumer goods industries. Mineral discoveries have caused dozens of new cities and towns to spring up in the Canadian northlands. Billions of dollars of investments in the expansion of Western Canada have depended upon the venture capital that succeeded in discovering oil, gas, potash and other minerals. Given their favorable cost position and world market opportunities, minerals investment has had a high leverage upon total investment in Canada.¹¹

For this reason, the White Paper's proposals to reduce the present level of incentives for the Canadian mining industry would lead to a less optimum utilization of resources. The White Paper's proposals would lead to a decline in resources devoted to mining, with possibly some increase in the resources devoted to the relatively less efficient manufacturing sector.

¹¹Neil H. Jacoby, *Canada's Tax Structure and Economic Goals*, Toronto, York University, 1967, pp. 30-31. Dr. Jacoby was born in Canada and is a graduate of the University of Saskatchewan. He is currently a professor at the University of California at Los Angeles, having been for many years Dean of its Graduate School of Business, and is a former member of the President's Council of Economic Advisors.

Inco believes that the concept of neutrality cannot be used in the analysis of an income tax system in isolation from the effects of other Government policies on the total deployment of Canadian resources. The special needs and benefits of the mining industry have been reflected in special tax treatments afforded it in many countries throughout the world. The maintenance of a substantial level of mining incentives in Canada is essential to a proper and balanced growth of our national and regional economy. Such growth can only be sustained by a level of mining incentives that creates a favorable competitive environment for mining investment in Canada that is fair both to the mining industry itself and to other Canadian taxpayers.

The proposed reduction in incentives for opening up northern and remote areas would occur at a time when the Government is committed in many of its major activities, and at very considerable expense, to optimum development in these areas. This apparent inconsistency is all the more serious because of the important contribution made by mining and other resource industries to provincial revenues, and in launching development in areas of particular significance for provincial growth objectives. The revenue needs of the provinces are of special concern at present, and continued new mining development is an essential element in meeting these needs.

Mining incentives have historically been recognized in Canadian Government policies as a means of providing the initial impetus for productivity in underdeveloped areas. In other countries with similar needs, the importance of such inducements is also universally recognized. The industry has the unique capability of opening up and supporting revenue-producing activity in territories that cannot initially support other industry. The industry is also export-oriented so that it makes an important contribution to maintaining a favorable balance of payments. An expanding mining industry, therefore, contributes significantly to the achieving of established provincial and federal goals.

C. GROWTH, EFFICIENCY AND MANAGEMENT

A number of studies have pointed out the persistent gap between real incomes in Canada and the United States, and have discussed the reasons for the lower per capita productivity in Canada, which is the major reason for this gap. (A number of such studies sponsored by the Economic Council of Canada and others are noted and discussed in Appendix D.) These studies have identified the significance of the composition of the labor force, its educational training, its technical competence and its managerial ability.

Canada's effort to increase its productivity by improving the technological and managerial abilities of its work force, and by increasing employees' motivation, mobility and effectiveness would be hampered by the White Paper's proposals. One of the main reasons for this unfavorable impact is that the proposals would widen the already large tax differential between U.S. and Canadian middle

management and skilled worker groups and, even more importantly, would result in marginal tax rates on these groups that would be sharply higher in Canada than in the United States. In addition, the proposed taxation of the accrued gains of residents of Canada who are leaving the country will have adverse effects on the supply of technical and managerial talent to Canadian industry and on the ability of Canadian multinational firms to deploy their personnel effectively. Certain aspects of the relatively high average and marginal personal tax rates proposed in the White Paper, and their adverse effect on Canadian productivity are discussed in Appendix D.

This appendix compares marginal rates under the old and the proposed systems. The data presented with respect to comparative marginal rates of the United States and Canada are particularly important. These data exclude both Social Security and the Canada Pension Plan contributions, and take account of normal deductions rather than merely standard deductions, and of average levels of state income tax. (See also Appendix D for a range of such comparisons.) These calculations disclose the following differences as examples:

Marginal Rates (Married Homeowner With Two Dependents)		
<u>Gross Income</u>	<u>Michigan¹²</u>	<u>Ontario¹³</u>
\$12,000	21%	36%
15,000	24	38
20,000	27	42
25,000	30	46

Contrary to the view expressed in the White Paper (paragraph 8.37) that the increases in marginal rates "do not seem large enough to change behavior patterns to any marked degree," it is suggested that there will be significant negative effects on Canada's ability to attract and motivate the groups so urgently needed to meet objectives of growth and productivity.

¹²After implementation of the Tax Reform Act of 1969.

¹³Assuming implementation of the White Paper.

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Appendix A

INCO'S DIRECT CONTRIBUTION TO CANADA'S BALANCE OF PAYMENTS

**Estimated Direct Impact of The International Nickel Company of Canada, Limited on Canada's
Balance of International Payments in 1968**

Current Account Transactions*Receipts:*

Merchandise exports:	
To foreign subsidiaries	\$397,200,000
To all other non-Canadian customers	82,400,000
	<u>\$479,600,000¹</u>
Interest and dividends received from non-residents	200,000
Total receipts	<u>\$479,800,000</u>

Payments:

Merchandise imports from:	
U.S. and U.K. subsidiaries	\$ 4,900,000
All other non-Canadian suppliers	11,500,000
	<u>\$ 16,400,000</u>
Inco Canada dividends (net of Canadian withholding tax) paid to non-resident shareholders	64,700,000
Interest (net of Canadian withholding tax) paid to non-resident holders of 6.85% debentures	3,200,000
Market development, exploration and other expenditures paid to non-residents	<u>12,700,000</u>
Total payments	<u>\$ 97,000,000</u>
Excess of current account receipts over payments	\$382,800,000

Capital Account Transactions*Receipts:*

Proceeds of 6.85% debentures sold to non-residents	\$145,900,000
Repayment of advances to and reduction in merchandise receivables from non-Canadian affiliates (net)	46,600,000
Repayment by non-resident of long-term loan	800,000
Purchases of Inco Canada stock by non-resident employees under stock option plan	1,000,000
Total receipts	<u>\$194,300,000</u>

Payments:

Investments in non-Canadian companies	24,000,000
Excess of capital account receipts over payments	<u>170,300,000</u>
Total excess of receipts over payments	<u>\$553,100,000</u>

**Summary of Net Current Account and Net Capital Account
International Transactions for Canada in 1968**

	Total Canada ²	International Nickel
Net Current Account Transactions	(\$ 60,000,000)	\$382,800,000
Net Capital Account Transactions	409,000,000	170,300,000
Total—Excess of receipts over payments	<u>\$349,000,000</u>	<u>\$553,100,000</u>

¹Represents 3½% of Canada's total merchandise exports of \$13,500,000,000 in 1968.

²Bank of Canada, *Annual Report of the Governor to the Minister of Finance, 1969.*

Appendix B

EFFECTIVE TAX RATES—DEVELOPED COUNTRIES

GENERAL INCOME TAX PROVISIONS APPLICABLE TO A NICKEL MINING COMPANY

	CANADA		UNITED STATES ¹		AUSTRALIA	SOUTH AFRICA
	Present Law	White Paper Proposals				
Maximum normal federal corporate income tax rate	50%	50%	48%		45%	40%
Maximum federal effective rate after depletion or other allowance	33 1/3%	50%	24 1/2% (Minimum)		36%	40%
Depletion or other allowance	33 1/3% of net production profits	None, except for allowance of one-third of "eligible expenditures" incurred up to 33 1/3% of net production profits	Greater of— (a) 22% of gross income from the property limited to 50% of taxable income from the property; or (b) Amortization based on cost depletion	20% of net income derived from mining		None
Tax exempt income	First 36 months of production from a new mine	None after 1973; New depreciation class to allow up to 100% depreciation of new mine assets	None	None		None
Prospecting and exploration expenses	Immediate write-off if incurred in Canada	Immediate write-off if incurred in Canada	Immediate write-off without limit if incurred within the United States, subject to recapture if successful	Immediate write-off if incurred in Australia		Must be capitalized if mining lease granted. If no lease, then current write-off
Development expense	Immediate write-off if incurred in Canada	Immediate write-off if incurred in Canada	Immediate write-off	Immediate write-off		Deductible in year incurred; expenditures prior to production subject to amortization
Depreciation	Declining balance method at rates to 100% (Typical rate 30%)	Declining balance method at rates to 100% (Typical rate 30%)	Various methods, including declining balance and straight line at rates to 20%	Various methods including declining balance at rates to 22 1/2%		25% initial allowance; balance subject to annual redemption allowance over life of mine or 30 years, whichever is less
Investment allowance	None	None	None	Investment allowance (deduction from income) of 20% on plant facilities used in concentration and subsequent activities, in addition to depreciation allowances based on 100% of cost		None

¹ Recognized Tax Reform Act of 1969.² Portion of depletion allowance subject to a 10% preference tax if it exceeds income tax liability plus \$30,000.

EFFECTIVE TAX RATES—DEVELOPING COUNTRIES
GENERAL INCOME TAX PROVISIONS APPLICABLE TO A NICKEL MINING COMPANY

	GUATEMALA	INDONESIA ²	DOMINICAN REPUBLIC ³	BRAZIL	PHILIPPINES
Maximum normal federal corporate tax rate	48%	45%	38%	33.5%	35%
Maximum federal effective rate after depletion or other allowance	34% (Minimum) ¹	37½% (1st 10 years production)	33%	33.5%	17½% (Minimum)
Depletion or other allowance	Amortization based on cost depletion. Reduction of tax for: use of domestic materials and location of plants; 10% and 20% respectively	Amortization based on cost depletion	None	Greater of— (a) 15% of gross income from the property, or (b) Amortization based on cost depletion	23% of gross income, not to exceed 50% of net income
Tax exempt income	Processing profits of first 5 years of operations are exempt; next 5 years, subject to a reduction of 50%	None	None	Full exemption from income and other taxes for 10 years if project is located in certain development regions	None
Prospecting and exploration expenses	Immediate write-off if incurred in Guatemala	Annual amortization ranging to 12½% of costs	Immediate write-off	Immediate write-off or 5 year amortization or capitalized subject to depletion	No special provisions
Development expenses	Amortized ratably on production	Annual amortization ranging to 12½% of costs	Annual amortization at 10%; (patents @ 5% for first \$10 million)	Immediate write-off or 5 year amortization	No special provisions
Depreciation	Straight line method at rates to 60%	Straight line method at rates to 12½%	10% annually	Straight line method at rates to 50% (Typical rate is 25%)	Up to twice straight line rate
Investment allowance	Reinvestment allowance of 33% of net profits if reinvested in Guatemala	Investment tax credit (reduction of tax) 8% of asset cost in addition to depreciation allowances based on 100% of cost	None	None	None

Other Nickel Areas

NEW CALEDONIA: No corporate income tax. A system of duties is applicable on exported mineral products.

¹Subject to further possible reduction during first ten years of production.

²Based on agreement between Government of Dominican Republic and Falconbridge Nickel Mines Limited.

March 1970

Appendix D

ECONOMIC APPRAISAL OF THE PROPOSALS FOR TAX REFORM

D. J. Daly*

The general purpose of this Appendix is to appraise some of the broad economic effects of the *Proposals for Tax Reform*. It is accepted that Canada's tax systems are in need of reform, change and improvement. The *Report of the Royal Commission on Taxation* and the related briefs, hearings and staff studies have documented the need for a variety of changes in the existing tax systems. The recent *Proposals for Tax Reform* draws on the Royal Commission's recommendations and the subsequent responses to it.

The White Paper states explicitly the goals and standards which guided the Government in its approach to reform in paragraphs 1.6 to 1.15. The author of this Appendix basically accepts these general goals. However, the White Paper is deficient in several respects. One is that the only information on future revenue collections five years after implementation is based on 1969 income levels. This is quite an unrealistic basis of estimation in a growing economy. A more realistic revenue projection would indicate more buoyancy under the proposed tax structure than the present one, and make less necessary the tax increases that the White Paper proposes. A second area that will be explored is how well the *Proposals for Tax Reform* meets the objectives stated, particularly the objectives of economic growth and productivity. This Appendix will also concentrate on the concept of neutrality in the tax system, when significant elements of non-neutrality are present in other areas of government policy, and the effects of the personal income tax rates on incentives and international movements of key personnel.

The revenue yields and the effects on incentives and growth from the *Proposals for Tax Reform* will be appraised against some of the broad goals set out by the Government of Canada in the legislation establishing the Economic Council of Canada. These goals were set out more explicitly and comprehensively in the *First Annual Review* and have been restated in subsequent reviews and used as a guide in appraising the performance of the Canadian economy.

*This memorandum has been prepared at the request of The International Nickel Company of Canada, Limited by D. J. Daly, A.B., B.Commerce, M.A. (Queen's University), Ph.D. (The University of Chicago). Dr. Daly is Professor of Administrative Studies, York University; former assistant director, Economic Division, Department of Trade and Commerce; former senior staff member, the Economic Council of Canada.

Future Revenue Yields

The *Proposals for Tax Reform* takes a very static view of incomes in its estimates of future revenues. The estimates for the first and fifth years after implementation of the proposed changes are all prepared on the basis of 1969 incomes. This section will show that this is an unrealistic basis of projection and that there would be a tremendous buoyancy in federal tax collections in the years ahead if the proposals were to be implemented. Information on this point should have been provided to parliament and the general public, and this section will explain why more information on this matter is imperative.

It might first be noted that the Ontario government arrived at higher estimates of revenues five years after implementation of the White Paper's proposals than those provided by the federal Government, using the *identical* assumptions about the economy. The White Paper's estimates for Canada suggested an increase of \$630 million in total taxes five years after implementation. The Ontario estimates for Canada suggest an increase of \$1,285 million over the same time period and using the same assumptions.¹ At this date (mid-April), there is still not enough information on the federal estimates to develop any reconciliation or explanation of the differences.

In any forecast of tax collections, some assumptions about the rates of growth in national income must be made. The easiest way to do this for a number of years ahead is to base tax collections on the growth in potential output. Recent estimates on this basis have been prepared by the Economic Council of Canada and published in the *Sixth Annual Review*. Their estimates to 1975 indicate a rate of growth in potential output of 5.5 per cent a year for Canada.² The increase in employment allowed for in this estimate is 2.8 per cent a year. The whole analysis is based on the assumption of a high level of economic activity in the major industrialized countries, and especially in the United States.

Federal revenues reflect not only the physical growth in the economy, but also increases in the general level of prices and the changes in wages, profits and other incomes that are intimately interrelated in their changes over time. It is more difficult to know what might be a realistic allowance for future price change. The Economic Council of Canada would like to see price stability in the Canadian economy, and felt that price changes of 2 per cent a year over a series of years would be in line with their general goal. However, their goal of an unemployment rate of 3 per cent a year as their intermediate goal in a year of high economic activity could only be attained if the United States also had a low level of unemployment. A low unemployment level in the United States appears to be associated with price increases in excess of 2 per cent a year. Historical experience would suggest that low rates of unemployment in the United States and Canada would be reflected in price increases of much more than 2 per cent a year in

¹Revenue Impact of the Federal White Paper Tax Reform Proposals presented by the Honorable Charles MacNaughton, Toronto, mimeo, Feb. 2, 1970, p. 4.

²Economic Council of Canada, *Sixth Annual Review*, "Perspective 1975," Ottawa, The Queen's Printer, 1969, p. 12.

Canada. It has been six years since the Economic Council first set forth their goals for unemployment, prices, etc. During that period *the economy has not achieved either the unemployment goal or the price goal in any year*. Furthermore, the Economic Council has not provided any specific advice or guidance to the Government on how these two goals might be simultaneously achieved. Under these conditions, it would seem more realistic for forecasting purposes to assume that prices will continue to increase more rapidly than has been allowed for by the Economic Council of Canada. An allowance of 4 per cent a year in the rate of change in the price index for the Gross National Product would be more appropriate, which is roughly in line with the experience of the last five years.

In the past, increases in the level of Gross National Product have been reflected in a relatively more rapid rate of increase in federal tax collections, *with no changes in tax rates*.³ An important factor in the buoyancy of federal tax collections has been the significant buoyancy in personal income tax collections. This buoyancy helps explain the increased relative importance of the personal income tax in the federal revenue system over the last twenty-five years. The quantitative extent of this buoyancy in personal income tax collections reflects the effects of the personal exemptions and the progressive rate structure in the personal income tax. For example, as an individual's income increases, his taxable income increases relatively more rapidly. Furthermore, it is possible that he will move into a higher tax bracket with an increase in his marginal tax rate. As an illustration of the magnitudes involved, from 1960 to 1968 when GNP went up 94 per cent, personal income tax collections went up 182 per cent.⁴

Under the changes proposed in the *Proposals for Tax Reform*, the revenue buoyancy will be even greater as incomes increase than under existing tax rates. For one thing, the introduction of increased basic exemptions, the employment expense allowance and the child care allowance will widen the difference between total income and taxable income for all taxpayers. Furthermore, the proposed marginal rates are higher than the present marginal rates on taxable income up to a level of approximately \$15,000, which covers a significant proportion of the taxable public.

What is urgently needed is a comparison of tax collections under the existing tax system and the proposed one, based on more realistic assumptions about economic growth and price changes. The estimates of potential economic growth by the Economic Council of Canada provide a convenient basis to begin. Their estimates in the *Sixth Annual Review* allow for increases from 1967 to 1975 of 2.8 per cent per year in employment and 5.5 per cent a year in total real GNP. Some allowance for further increases in prices seems necessary on the

³D. J. Daly, "Variability in Federal Tax Collections," *Canadian Tax Journal*, September-October 1964. This emphasis on the buoyancy in federal revenues at given tax rates has also appeared in the projections of the Economic Council of Canada in the *First* and *Sixth Annual Reviews* and both studies of future revenues and expenditures made by the Tax Structure Committee.

⁴Budget Appendix, *Votes and Proceedings*, March 2, 1970, pp. 57 and 113. This covers both federal and provincial collections, as all provinces now get a share of the personal income taxes collected in their province.

basis of past experience in both the United States and Canada. If such estimates of economic growth are used as a basis of revenue projections, the increases in tax collections over a five-year period will be very marked. Preliminary calculations of increased tax collections at the federal level by the end of a five-year period suggest increases of the order of \$8 billion annually under the present tax structure. Increases under the new rates and exemptions suggested in the *Proposals for Tax Reform* would be significantly greater.

It might be noted that in testimony earlier this year, Mr. J. R. Brown, Senior Tax Advisor in the Department of Finance, in response to an inquiry from Mr. Ritchie, stated, "my answer to you is that those forecasts of that nature were not made," and Mr. R. B. Bryce indicated that estimates would be prepared for the Committee if appropriate assumptions were suggested.⁵ This would be a valuable contribution to the discussion of the White Paper, and reasonable assumptions could be used along the lines already used in this area by the Economic Council of Canada and the Tax Structure Committee.

It might also be noted that a continuation of general price increases will lead to increases in the value of land, residential property, business property and facilities, and common stock. The increases in price of these assets will be taxable under the proposed capital gains measures when those assets are sold (with allowance for rollover of residences and some price increase per year). In addition, accrued gains and losses on shares of widely held Canadian companies would be revalued at market prices every five years and one-half of the resulting gain or loss would be taken into income. Under inflationary conditions, even if mild, there will be important taxation of capital gains arising out of inflation alone.

The buoyancy of federal revenues in a growing economy has important implications for both the federal financial position and federal-provincial finances. This area was discussed in a recent speech by H. I. MacDonald, Deputy Treasurer and Deputy Minister of Economics of Ontario. He pointed out that:

It is an acknowledged fact that, even without implementation of the White Paper proposals, the federal Government will accumulate substantial surpluses in the 1970's whereas the provincial-municipal sector will incur increasingly large deficits. The findings of the Economic Council of Canada and the research undertaken on two separate occasions for the Tax Structure Committee support that assertion. Thus, although modern social needs will press most heavily on the provincial-municipal sector in the future, the White Paper proposals, when fully implemented, would leave the provinces no worse off than before and would increase the flow of tax revenues to the federal government. A fundamental mismatching of fiscal responsibilities and tax revenue flows would be the inevitable result In view of the projected disparities in financing requirements for the federal and provincial-municipal sectors of government, any underestimate of potential tax revenue growth in the White Paper is of great concern to Ontario. There is every reason to agree that the potential growth of tax revenue, that is to say, its elasticity with respect to economic growth, could be significantly greater

⁵Standing Committee of Finance, Trade and Economic Affairs, Minutes of Proceedings and Evidence, January 20, 1970, pp. 24-26.

than that of the present system. In that case, the federal Government's fiscal dividend would increase dramatically in the future and, thereby, exacerbate the projected fiscal mismatch.⁶

The earlier work by the author on Government revenues and economic growth and this study of the *Proposals for Tax Reform* confirm and reinforce Mr. MacDonald's conclusions in all respects.

We believe that the *Proposals for Tax Reform* will lead to an increase in federal revenues as the economy grows in the years ahead, far in excess of the White Paper estimates, on any reasonable basis of physical growth and price increases in line with historical experience. The use of 1969 income levels in the White Paper as a basis of revenues five years after implementation is an unrealistic basis for public and federal-provincial discussions. We would strongly advise the federal Government to appraise future revenue yields under the existing and proposed tax rates for 1975 on the basis of more realistic economic assumptions. In the light of the strongly and publicly expressed concerns about the revenue projections from key provincial ministers and officials, it is important that such revised revenue estimates get adequate professional discussion and review with provincial government officials.

Growth and Efficiency

The Royal Commission on Taxation was appointed in September 1962 and the basic staff work was done in 1963-64. The economic situation in Canada at that time reflected considerable underutilization, high unemployment, and price changes that were fairly moderate. Significant changes have taken place since then. The United States and Canadian economies have experienced one of the most prolonged and sustained economic expansions in history. Levels of unemployment have been well below the rates of the late 1950's and early 1960's, and price increases have been more widespread and pronounced than anything experienced since early 1951.

This change in the economic situation has been associated with a shift in emphasis from a discussion of the *full utilization* of resources within Canada to greater emphasis on the *efficiency* with which resources are used. As the Carter Commission observed, "The increased concern with economic growth relative to the problems of economic stability represents a return to normal rather than a departure from tradition."⁷

This emphasis on the efficient use of resources is particularly appropriate at this time. The increasing affluence of Canadians has been reflected in higher aspirations for personal consumption and a larger and more varied range of public services. Illustrations of the range of public services adopted or under active discussion include Medicare, higher standards of university and post-secondary education, poverty and pollution. In some areas, the increased private and public eco-

⁶H. I. MacDonald, *Address to the Canadian Tax Foundation Conference on the White Paper on Proposals for Tax Reform*, Montreal, March 25, 1970.

⁷*Report of the Royal Commission on Taxation*, Vol. 2, p. 117.

conomic objectives reflect the increased awareness through television and better communication of the higher economic standards in the United States. However, the levels of individual consumption and public expenditures can only begin to match those in the United States if the historical and current gap in productivity levels between Canada and the United States can be narrowed.

Some facts may help to provide perspective on this gap in productivity.⁸ Net national income per person employed has traditionally been lower in Canada than in the United States. The possibility of any differences in the level of prices between the two countries should also be considered. Prices of manufactured products are typically higher in Canada than in the United States, but these are offset by the lower prices of services and some foods in Canada. After taking account of a wide range of prices in both countries, it would appear that in 1965 prices in Canada were slightly lower (97.0 for GNP at market prices) than in the United States.⁹ In other words, the money income differences between the two countries can be used as a rough measure of the real income differences.¹⁰

In 1960, the level of real national income per person employed in Canada was about 20 per cent less than in the United States.¹¹ In both countries, the levels of output per person employed could be affected by the composition of the employed group, the educational level, and the quantity of other factors of production (such as capital and natural resources). The general level of education of those employed is lower in Canada, with fewer having a university degree, and fewer having finished high school. On the other hand, there is a larger quantity of agricultural land and natural resources per employed person in Canada than in the United States. The levels of capital stock per employed person are almost the same in the two countries. When all the individual factors are weighted by their relative importance in national income, the quantity of all factors per employed person are roughly the same in the two countries.

The key conclusion is that *almost all of the differences in output per person employed in the two countries reflect the efficiency with which resources are used*, rather than the quantities of the other factors of production.

This provides a framework within which the concept of neutrality, and the question of whether the proposed tax changes move closer to neutrality, can be examined.

Neutrality

Historically, many objectives of a system of taxation have been

⁸For a short presentation of this material see D. J. Daly and D. Walters "Factors in Canada-United States Real Income Differences," *International Review of Income and Wealth*, Dec. 1967, pp. 285-309. Greater detail, as well as changes over time, are provided in D. Walters, *Canadian Income Levels and Growth: An International Perspective*, Economic Council of Canada, Staff Study No. 23, Ottawa, The Queen's Printer, 1968.

⁹Daly and Walters, *op. cit.*, p. 289 and Technical Appendix by E. C. West.

¹⁰It would be inappropriate to use the official exchange rate as a measure of the differences in domestic purchasing power in the two countries. See the references in the discussion of the levels of the personal income tax in Canada and the United States in a later section.

¹¹Daly and Walters, *op. cit.*, p. 290.

proposed as guides. Most of the leading authorities in taxation have suggested three or four standards by which a tax structure should be judged. The Royal Commission on Taxation recognized a variety of objectives, including growth and stability of the economy, but stressed equity and also gave considerable emphasis to economic neutrality in its Report.

The Commission stated its objectives in this respect as follows:

Maximization of the rate of increase in the productivity of all Canadian resources assuming full employment is achieved. This objective has two aspects:

a. The tax system should be neutral in the sense that, with explicitly specified exceptions, it should be designed to bring about a minimum change in the allocation of resources within the private sector of the economy relative to the allocation that would take place in the absence of taxes. Such neutrality is desirable because, at least in the present state of knowledge, the allocation of resources in response to free market forces will in general give in the short run the best utilization of resources, and in the long run the most satisfactory rate of increase in the output of the economy.

b. Where there are imperfections in the market mechanism, as the result of uncertainty, immobility of the factors of production, monopoly power, and so on, the tax system should be used to change the allocation of resources to compensate for these imperfections.¹²

The author would assign high priority to the goals of a high level and a maximum rate of increase in, the productivity of all Canadian resources. In the previous section it was pointed out that the levels of output in relation to labor and other resources in Canada are significantly lower than in the United States. High priority should be given in all parts of the Canadian economy to narrowing that productivity gap in the years ahead. The author would also agree that a total system of Government policies that was *essentially neutral* would provide a high level of productivity and an efficient use of resources from the point of view of both producers and consumers. Furthermore, the efficient use of resources domestically and the higher levels of productivity associated with it could facilitate the achievement of a strong balance of merchandise trade and balance of payments position and ease any balance of payments constraints that could otherwise be present.

The main argument of this section of the Appendix is that the recommendations of the Royal Commission on Taxation and the *Proposals for Tax Reform* do not in fact provide a truly neutral system in respect to the allocation of resources between industries within Canada. A number of studies by the Economic Council of Canada and several major studies by Canadian economists indicate that the current pattern of tariffs contributes to a significantly higher level of prices of manufactured products and a lower level of productivity in Canadian manufacturing than would be associated with a neutral system of taxes and tariffs.¹³ All of these studies have been published since the Royal Commission on Taxation was completed, but the

¹²Report of the Royal Commission on Taxation, Vol. 2, Ottawa, The Queen's Printer, 1966, pp. 8-9.

¹³D. J. Daly, B. A. Keys and E. J. Spence, *Scale and Specialization in Canadian Manufacturing*, Staff Study No. 21 for the Economic Council of Canada, Ottawa, The Queen's Printer, 1968, and references cited there.

results of these studies have not been reflected in the *Proposals for Tax Reform*. The evidence from these studies will be summarized to show the significant degree of non-neutrality created by Government policies in this area, and the results on productivity levels in Canada.

The latter part of this section will summarize some recent economic literature that bears on the latter part of the quotation from the Carter Commission. If there are significant imperfections in the system, it is quite in accord with the achievement of neutrality to offset the non-neutral treatment in one area of Government policy by compensatory treatment in another. It will be shown that this discussion is quite relevant to the Canadian situation, where the proposal to remove the historic incentives to the mining industry when the encouragement of manufacturing employment by the tariff structure is continued may make the whole system less neutral than it now is.

The essence of the argument is that the attempt to achieve neutrality in the tax system in isolation really increases the degree of non-neutrality in the total system of taxes and tariffs.

Most discussions of tariff rates in Canada and elsewhere look at nominal tariffs—the tariff rate in relation to the delivered cost (before tariffs) of the item. However, the significant difference in tariff rates between primary materials and finished products requires special analysis in any appraisal of the effects of tariffs on productivity levels. This approach is particularly important for Canada in the light of the importance of imported materials and components for Canadian manufacturing, the significant difference in tariff rates between different products and the degree of processing of them, and the widespread practice of setting the laid down price of imports as an upper limit on prices of the same item in the Canadian market.

Quantitative estimates of the extent of effective tariff rates in Canada have been published recently.¹⁴ In general, effective rates are typically higher than the nominal rates, and this difference is striking in the Canadian results. The weighted mean of the 133 industries distinguished in that study was 13.1 per cent for the nominal rates but 21.0 and 24.4 per cent for the two alternative calculations of the effective rates. In addition, the variation in effective rates from one industry to another is much greater than for nominal rates. Furthermore, the levels of effective rates have not been reduced to any significant degree by the reductions in tariffs under the Kennedy Round of tariff negotiations which are now fully implemented in Canada.

What are the effects of these tariffs on Canadian manufacturing? Many Canadian manufacturing firms set the prices of the items produced and sold within the domestic market on the basis of the price of the same item in the United States, plus transportation and other costs, the Canadian tariff, and an adjustment for the exchange rate. This is reflected in a clear tendency for prices of manufactured

¹⁴See James R. Melvin and Bruce W. Wilkinson, *Effective Protection in the Canadian Economy*, Special Study No. 9 for the Economic Council of Canada, Ottawa, The Queen's Printer, 1968. This includes a full statement of the concept, the methods of computation, an interpretation of the results, including an appraisal of the Kennedy Round and a full bibliography.

products in Canada to be higher than for the same item in the United States.¹⁵ Such a large and persistent gap between prices of manufactured products in the two countries could not persist without the protection provided by the Canadian tariff. However, the level of wage rates in individual manufacturing industries is generally lower than in the same industries in the United States, and for total manufacturing is about 20 per cent less than the average in the United States. Thus, the higher level of manufactured goods prices in Canada has not been reflected in a higher level of money wages, even though total wages and salaries are a very significant part of net national income in manufacturing. Furthermore, profit rates in manufacturing in Canada are not significantly different from those in the United States, whether in relation to sales, total assets or equity.

The major effect of the presence of tariffs is a *significantly lower level of output per employed person in total manufacturing in Canada than in the United States*. This also appears in a majority of the individual industries within manufacturing. The tariff permits higher prices in Canada, and this in turn encourages a larger number of plants, a larger number of manufacturing firms, and a much wider range of products being produced within individual Canadian plants. With relatively unrestricted entry into Canadian production of new firms and no limitation on the range of products they can produce, the tariff encourages the proliferation of products for individual producers and short runs of each item. The resulting short runs for individual items contribute to the maintenance of higher prices and lower productivity levels than the same product in the United States.¹⁶

This pattern of prices and productivity for Canadian manufacturing is significantly different from the situation in the production of Canadian raw materials and natural resources. The major industrial countries have traditionally had low or even no tariffs on these items, and further reductions are taking place under the Kennedy Round.¹⁷ Many Canadian producers take the world price as given, especially if their output is too small a part of the world supply to affect the world price. The returns to the Canadian producer are the world price, less any tariffs levied by other countries, less transport costs to the major markets, with adjustment for the exchange rate where necessary. The prices to the Canadian producer of primary products sold in world markets are below the world price. This is in contrast to the higher prices for manufactured products. Furthermore, levels of

¹⁵See John H. Young, *Canadian Commercial Policy*, Ottawa, The Queen's Printer, 1957, Appendix A, pp. 163-233; J. R. Gates and F. Linden, *Costs and Competition: American Experience Abroad*, New York, National Industrial Conference Board, 1961; A. E. Safarian, *Foreign Ownership of Canadian Industry*, Toronto, McGraw-Hill, 1966; D. J. Daly, B. A. Keys and E. J. Spence, *op. cit.*; D. Walters, *op. cit.*, Appendix by E. C. West, pp. 253-260; and Herbert Segal and Frances Pratt, *Comparative Urban Price Levels in the United States and Canada*, Ottawa, DBS, Prices Division, 1967, mimeo, available on request.

¹⁶D. J. Daly, B. A. Keys and E. J. Spence, *op. cit.*, especially pp. 39-47. For a discussion of the economic theory of the effects of volume of output and width of output rate on the cost per unit in the individual firm, see the references to Alchian and Hirschleifer on p. 42.

¹⁷It is recognized that there are exceptions to this generalization for individual products and individual countries, when tariffs or non-tariff barriers exist, or where individual countries are encouraging production domestically of some primary product, mineral, petroleum, or forest product. Some of these affect Canadian firms and some qualifications to the generalization should not be overlooked.

output per person employed in these primary sectors are frequently close to or even higher than in the United States. Wage levels in some of the extractive industries within Canada are sometimes close to the levels in the United States.

The strong competitive position of Canadian resource industries in world markets is reflected in large exports of these items. Sales of primary export staples has historically had a significant role in the Canadian merchandise trade and balance of payments position. Even though trade in minerals, forest and agricultural products has been a shrinking part of world trade on a long-term basis, the Canadian share of a number of forest and mineral products has been growing. This confirms the continued competitive position of these sectors of the Canadian economy.

The evidence summarized thus far indicates that the Canadian tariff on secondary manufacturing introduces a significant degree of non-neutrality into the Canadian economy. What are the implications of this for taxation?

The most important recent developments in the discussion of neutrality have occurred in the discussion of welfare economics and its application to tariffs and international trade. However, the implications are fully applicable to the discussion of neutrality in the Canadian tax system.

This discussion of tariffs and international trade would accept the view explicit in the Carter Commission and implicit in the *Proposals for Tax Reform* that a completely neutral system of taxes and tariffs would provide an efficient use of resources and a high rate of economic growth, and this would be the best solution. But if differential taxes and subsidies on individual products and industries existed in individual countries, they would prevent the attainment of the most efficient use of resources. In this case, selective tariffs to offset the selective taxes would provide a more efficient economic result in the country than no tariffs. Differential incentive rates in one part of the system could offset differential discouragement in another part of the system and provide a result close to a system that was neutral in all areas of Government policy. This has been referred to as the general theory of the second best.¹⁸

In the Canadian case, where tariffs provide a significant degree of protection to Canadian manufacturers even after the Kennedy Round, neutrality in the tax system alone will *not* provide an efficient use of resources within Canada, taking account of the inherent comparative advantage of Canadian resource industries in world markets. On the contrary, there would be advantages if full and real neutrality is the goal of economic policy to use domestic taxes and subsidies to *encourage* Canadian mining and resource industries to offset the existing significant encouragement to Canadian manufacturing provided by tariff.

¹⁸For convenient summaries of this discussion, see R. G. Lipsey and K. Lancaster, "The General Theory of the Second Best," *Review of Economic Studies*, 1956-57, pp. 11-32 and H. G. Johnson, "Optimal Trade Intervention in the Presence of Domestic Distortions" in R. E. Caves, P. B. Kenen and H. G. Johnson, eds., *Trade, Growth and the Balance of Payments*, North Holland, 1965, pp. 3-34.

By neglecting the effect of the tariff in maintaining a significant degree of non-neutrality in the Canadian economy, the recommendations of the Carter Commission and the *Proposals for Tax Reform* on the treatment of oil, gas and mining would *increase* the overall degree of non-neutrality, rather than reduce it. This partly arises from the terms of reference of these two studies, but such omissions can not be neglected in any serious attempt to get a more efficient use of resources within the Canadian economy as part of a broader world economy.

Personal Income Tax Rates

The Royal Commission on Taxation concluded that many features in the existing personal income tax and related features of other taxes (such as the corporation profits tax, estate and gift taxes) had undesirable effects on the equity and efficiency of the tax system. A number of the basic recommendations have been accepted by the Government and incorporated into the *Proposals for Tax Reform*. Some of these changes include the taxation of capital gains, the partial integration of business and personal taxes, greater use of averaging, and stricter limitations on various fringe benefits received by employees or by the owners of business. A number of these changes are useful and important in contributing to a tax system that will be more equitable in its treatment of individuals and improve the tax system as a whole.

Some of the important criticisms of the existing tax structure made by the Carter Commission were that the existing tax system bore fairly heavily on the lower income groups, while the marginal tax rates became very high at the upper income levels. The top marginal rate is now about 80 per cent and applies to annual income in excess of \$400,000, but there are a number of loopholes that can be used to obtain financial benefits in ways not subject to income tax. The Carter Commission recommended that the tax base be widened in a number of important respects (capital gains and the integration of personal and corporate taxation, for example) but that the rate schedules have a top marginal rate of 50 per cent. In commenting on this, the Commission report stated:

Although we have no evidence to support our contention, we are convinced that high marginal personal rates of tax do have a negative effect on labour, managerial and professional effort. In arriving at our recommendations we have therefore proposed rate schedules in which they are reduced.¹⁹

The *Proposals for Tax Reform* accepts the key features of the Royal Commission Report relating to the personal income tax and its relationship with other taxes. The reduction of the top marginal rates to 50 per cent at the end of five years is accepted. Personal income taxes paid by lower income groups will be decreased by an increase in personal exemptions, an employment expense allowance, and a child care allowance. These changes would reduce personal income tax collections, with the revenue effects of the increased basic exemptions

¹⁹ *Report of the Royal Commission on Taxation*, Vol. 2, Ottawa, The Queen's Printer, 1966, p. 128.

amounting to \$1,000 million per year.²⁰ However, the marginal tax rates for the middle income groups have been increased so as to largely offset the reductions in tax collections that arise from the increased exemptions and the wide variety of other changes. The rate schedule changes yield an additional \$1,255 million on 1969 incomes, leaving total personal income tax collections under the proposed system roughly unchanged at 1969 income levels.²¹

The net effect of these changes from the existing personal income tax structure is to increase the marginal rates for the professional and managerial groups. The Carter Commission changes would have reduced the total income taxes for a married taxpayer with two dependent children and an income of \$30,000 (with wage and salary income only) from \$12,320 at the rates then prevailing to \$8,844, a very significant reduction.²² Under the *Proposals for Tax Reform, instead of a significant reduction* as proposed by the Royal Commission, *there is a moderate increase* under the comparable situation.²³

The net effect of these changes in marginal and average personal income tax rates will be considered in three areas:

- a. the effect on future personal income tax yields;
- b. the effect on incentives in the context of the importance and relative scarcity of professional and management training and skills in Canada; and
- c. the differences in money incomes and tax rates between Canada and the United States and the effects on flows of skilled people.

(a) Future Personal Income Tax Yields

In the past there has been a persistent and marked upward trend in the collections under the personal income tax, even with unchanged personal income tax rates, primarily from economic growth combined with rising prices and incomes. Three things have contributed to this upward buoyancy. One factor is the increase in the numbers employed, but the rate of increase in tax collections has exceeded the rate of growth in the number of taxpayers. The additional buoyancy has come from the structure of the personal and other deductions, and the progressive rate structure. The effect of the personal exemptions and other deductions is particularly significant. For example, suppose a married man with no dependents got an increase in basic income from \$3,000 to \$4,000, an increase of one-third. However, his taxable income would go up from \$1,000 to \$2,000, or twice as much. This contributes to relatively larger increases in taxable income than total income. In addition, some individuals will shift from a lower to a higher marginal tax bracket as their incomes increase,

²⁰*Proposals for Tax Reform*, Table 15, p. 95. The effects of the employment expense allowance, child care allowance, and the full reduction of top rates in the rate schedule are much smaller, amounting to \$235, \$95 and \$40 millions respectively.

²¹*Op. cit.*

²²*Report of the Royal Commission on Taxation*, Vol. 1, The Queen's Printer, 1966, Table 1, p. 33.

²³*Proposals for Tax Reform*, Table 6, p. 29. Tax increases are shown for married taxpayers with initial incomes over \$10,000 and single taxpayers over about \$4,000 in Tables 4 to 10, pp. 27-33.

which further contributes to greater buoyancy.²⁴

The proposed increases in the personal exemptions in the *Proposals for Tax Reform* would raise these from \$1,000 to \$1,400 for a single person and from \$2,000 to \$2,800 for a married person without dependents. New exemptions for child care expenses for working parents and employment expenses are proposed. The net effect of these changes is to widen the difference between income received and taxable income, and thus further accentuate revenue increases as income per taxpayer goes up. Furthermore, the increases in marginal rates on taxable income start to increase more rapidly under the proposed rates than they do now. This will contribute to even greater increases in tax collections as incomes grow than at present.

It might be repeated that the estimates of tax changes from the first to the fifth year under the proposed tax scheme were based on 1969 incomes only.²⁵ The Government has not provided any estimate of the increases in tax collections as the economy grows, and the first section of this Appendix indicated that the assumption of 1969 income levels leads to a significant understatement of tax revenue.

(b) Marginal Tax Rates and Incentives

In showing the effects of the proposed personal income tax changes, the *Proposals for Tax Reform* concentrates on new total taxes and the change from the present tax (including the 28% provincial tax). The general picture shown is a reduction in tax for both the lower income taxpayers and the upper income taxpayers. However, beginning at about \$4,000 for a single taxpayer and \$10,000 for a married taxpayer, taxes are increased. After the reduction of top rates has been introduced, taxpayers with incomes of about \$40,000 and over will also have lower taxes on income from employment. It might be noted, however, that the number and share of taxpayers in these upper income groups is very small. The increases in taxes for the middle income groups emerge from offsetting influences—the reductions in incomes subject to tax (from higher personal exemptions and child care and employment expenses) are *more than offset by higher marginal tax rates*. It is the *marginal* tax rates rather than the level of total taxes that are important in considering the possible tax effects on personal incentives to work. Although the Government accepted the recommendations of the Carter Commission to reduce the taxes on the lower income groups and to reduce the top marginal rates to about 50 per cent at the end of five years, the marginal rates on the middle income groups have been increased rather than reduced. The comparison of the two marginal rate schedules is provided in the accompanying table. The proposed marginal rates on taxable income are higher than the

²⁴A much fuller discussion of these points and quantitative estimates of the influence of exemptions and the progressive rate structure on personal income tax collections is provided in D. J. Daly, *Estimating Collections from the Canadian Personal Income Tax*, Dept. of Economics, University of Chicago Press, March 1953, and D. J. Daly, *Federal Tax Revenues at Potential Output, 1960 and 1970*, Staff Study No. 9 for the Economic Council of Canada, Ottawa, The Queen's Printer, 1964.

²⁵*Proposals for Tax Reform*, Table 15, p. 95. The corporation income tax changes and the withholding tax changes were also shown only on the basis of 1969 incomes. See p. 96.

existing rates on all brackets of taxable income up to about \$15,000 in taxable income.

It should be noted again that it is the marginal tax rate that is important in considering the effects on incentives.

TABLE I

**PRESENT AND PROPOSED SCHEDULES OF RATES
APPLIED TO TAXABLE INCOME**

(Combined Federal and 28% Provincial Tax)

Present Taxable Income Bracket	Present Marginal Tax Rate in Bracket	Proposed Taxable Income Bracket	Proposed Marginal Tax Rate in Bracket
\$ 0-\$ 909	14.80%	\$ 0-\$ 500	21.76%
909- 1,000	17.00	500- 1,000	23.04
1,000- 1,643	20.00	1,000- 1,500	24.32
1,643- 2,000	20.42	1,500- 2,000	25.60
2,000- 3,000	23.51	2,000- 3,000	26.88
3,000- 4,000	25.57	3,000- 4,000	28.16
4,000- 6,000	28.66	4,000- 5,000	30.72
6,000- 8,000	26.78	5,000- 7,000	33.28
8,000- 10,000	30.90	7,000- 10,000	35.84
10,000- 12,000	36.05	10,000- 13,000	38.40
12,000- 15,000	41.20	13,000- 16,000	42.24
15,000- 25,000	46.35	16,000- 24,000	46.08
25,000- 40,000	51.50	24,000	51.20

Source: *Proposals for Tax Reform*, Tables 1 and 2, pp. 24 and 25.

(c) Canada—United States Income and Tax Differences

This section will consider the effects of differences in incomes and taxes on the flows of trained people between the United States and Canada. This is an important question as there is considerable evidence that Canada has a smaller share of its labor force with the type of advanced formal training for management and some of the specialized professions that are being used increasingly in the more efficient private and public organizations in North America.

In considering this topic it is important to realize that the levels of real income per capita and per employed person have been persistently lower in Canada than the United States throughout the present century. Currently, the gap in the levels of real income per employed person is about 20 per cent. This difference has probably been one of the factors contributing to the historical tendency for emigration to the United States being higher than immigration from the United States, although there is some evidence to indicate this has been changing in recent years.

When prices in Canada are compared with those in the United States, most observers are struck by the higher prices for manufactured products in Canada. This observation is also supported by all of the quantitative studies which have been made. However, it is also true that prices of a wide range of services and some food prices are

lower in Canada than in the United States. After taking into consideration the relative expenditures on the various groups of goods and services, a recent staff study for the Economic Council concluded that the general level of consumer prices was about the same in the two countries.²⁶ In other words, one can use the differences in money incomes between the two countries as a measure of real income differences.²⁷

For many groups in the population, the levels of money income in Canada are lower than are received by comparable groups in the United States, frequently close to the national average difference of 20 per cent lower. There are, of course, some groups with a difference less than the national average, but these are offset by those with a difference greater than the national average.

It has been established that Canada has a much lower proportion of its population and labor force with university training and some of the more specialized training and skills.²⁸ Even with the increasing proportion of those from 18 to 25 attending schools, universities and community colleges in Canada, the proportion is still significantly lower than in the United States.

In addition, important changes are taking place in the age and educational levels of people in many organizations. At present, there are some people at senior levels of Canadian business and industry with considerable experience, but sometimes with only limited formal training in newer areas of management expertise. However, the number of younger and more highly educated people has already begun to increase, and this will continue during the 1970's. There is likely to be a recurrent and even a persistent pressure of demand against a limited supply of highly trained people in Canada.²⁹ These underlying demand pressures for some highly trained middle income people in Canada provide some perspective for considering the levels of personal income tax in Canada and the United States, and the related marginal and average rates in the two countries.

In turning to the differences in tax rates, it should be recognized initially that it is not easy to make a comparison of taxation levels in the two countries. A full appraisal would look at the relative range of government functions and levels of services in the two countries. It would also look at the relative reliance on indirect taxes, corporation profits, taxes, and personal income taxes. However, in this

²⁶Dorothy Walters, *Canadian Income Levels and Growth: An International Perspective*, Staff Study No. 23 for the Economic Council of Canada, Ottawa, The Queen's Printer, 1968, Appendix by E. C. West, pp. 253-260.

²⁷When a person is earning and spending his income in Canada and considering shifting to the United States where he would earn and spend his income, it is the difference in price levels between the two countries that should be used for comparison rather than the official exchange rate. This is the correct procedure for these two countries or for any other. See Milton Gilbert and Associates, *Comparative National Products and Price Levels*, Paris, OEEC, 1958, pp. 29-31, and B. Balassa, "The Purchasing-power Parity Doctrine: A Reappraisal," *JPE*, 1964, pp. 584-596.

²⁸Economic Council of Canada, *Second Annual Review*, Ottawa, The Queen's Printer, 1965, Chapter 4 on "Education and Economic Growth"; G. W. Bertram, *The Contribution of Education to Economic Growth*, Staff Study No. 12 for the Economic Council of Canada, Ottawa, The Queen's Printer, 1966; and B.W. Wilkinson, *Studies in the Economics of Education*, Ottawa, The Queen's Printer, 1966.

²⁹D. J. Daly, "The Changing Environment for Management in Canada," paper presented to the Canadian Association of the Schools of Business at York University, June 1969.

the primary interest is to look at the tax effects on the movement of specialized management and executive staff back and forth between the two countries. In the light of the overall data on the smaller proportion of the Canadian labor force with formal training, this situation is not limited to an isolated firm or industry but is bound to be a widespread situation in Canada. In the longer term, the solution will be to increase the supply of Canadian trained people and to give them the time to develop maturity and experience, but this process will take a decade or more.

The White Paper Highlights issued by the Department of Finance concurrently with the release of the White Paper contains a section devoted to a tabular comparison of the relative tax burdens of Canadian and United States residents at various income levels. A tax bulletin prepared by Price Waterhouse & Co. sets out some alternative calculations which show the new United States personal income tax rates appreciably lower than the new rates proposed for Canada.³⁰ Five factors contribute to the differences in the two results, and these will be stated in point form.

1. The United States signed into law a tax reform bill on December 30, 1969, that reduced U.S. taxes and would have full effect for the 1973 taxation year. This occurred after the White Paper comparison of November 7, 1969.
2. The White Paper Highlights included Canada Pension Plan contributions and U.S. Social Security contributions. These are extra budgetary funds designed to be financed by the contributions of those who will subsequently receive benefits and are not usually regarded as income taxes by the governments themselves. Since the U.S. benefits are substantially higher, it was felt that a more comparable basis for the main tax comparison could be made by excluding them. Furthermore, the tax differences are still significant even if these deductions are treated as personal income taxes.
3. The White Paper Highlights uses the standard deductions (for charitable contributions and medical expenses), in both countries, with some modifications for upper brackets. The Price Waterhouse Bulletin uses the statistical average of actual deductions, which is widely used in tax returns, especially in the United States. This tends to reduce U.S. taxes compared to Canadian, as the actual deductions permitted are relatively larger than in Canada.
4. The White Paper Highlights did not take separate account of the tax position of the homeowner in the United States. That comparison was based on "average" taxpayers, and statistical average deductions for both homeowners and tenants were used in the calculation of both Canadian and United States taxable income. In the Price Waterhouse comparison of homeowners, estimated mortgage interest,

³⁰Price Waterhouse & Co., *A Comparison of Personal Income Tax Burdens: Canada, United States*, Canadian Tax Bulletin, Toronto, March 1970. The staff of Price Waterhouse & Co. have made available the underlying worksheets and provided special additional comparisons for this study, and their cooperation and assistance has been most helpful. Technical Notes on Tables 2 and 3 at the end of this Appendix set out the basis for these estimates.

property tax and other tax deductions have been used in place of the statistical average deductions. However, the income tax position of a Canadian homeowner is not affected, as these expenses are not deductible from income.

5. The White Paper Highlights compares the rates in Ontario and New York. However, New York is not representative, as it has one of the highest state income tax rates. The Price Waterhouse Bulletin also shows the difference for Ohio (which is one of a number of states with no state income tax), which shows a larger difference than the Department of Finance comparison. Similar comparisons can also be made for Michigan, which is representative of a significant number of states intermediate between New York and Ohio.

(d) Ontario–Michigan Comparisons

To provide a comparison between Ontario and a more representative state in the United States, Michigan has been selected. In the accompanying Tables 2 and 3 the methods used in the Price Waterhouse comparison have been followed, except that no allowance for the differences in the exchange rate has been made.³¹ Since the main interest of this Submission is in the tax position of mature married persons in middle and upper management positions, the comparisons will concentrate on the married taxpayer with two dependent children. (The differences for single persons and married persons in New York and Ohio can be seen in the Price Waterhouse Bulletin.) Table 2 shows that an average Michigan homeowner would pay between 35 and 54 per cent less tax than an Ontario homeowner, while the difference for homeowners and renters combined would not be quite as large. Table 3 shows essentially the same information in terms of the average effective rates. Although the differences in average rates are not large for single taxpayers, the average tax rate for Ontario homeowners is roughly *double* that for Michigan homeowners for incomes up to \$15,000, and the differences are significant up to \$50,000 gross incomes.

It is also useful to look at these comparisons in terms of any differences in marginal rates of tax in the two countries, as these are critical in influencing incentives to move to different levels of responsibility, to undertake extra projects and assignments or to move between countries. These are shown in Table 4. The marginal rates are about the same for single taxpayers with an income of \$40,000, and for married taxpayers at about \$50,000 or more. However, at some lower income levels, the differences in marginal rates are very marked.

³¹The assumption is that incomes earned in Canada are spent in Canada, while incomes earned in the United States are spent in the United States. A careful comparison of the level of consumer prices in the two countries suggests that the levels of prices in the two countries in the mid-1960's were about the same. See Segal and Pratt, *op. cit.*, D. Walters, *op. cit.*, Appendix by E. C. West, p. 260. In the light of this evidence, it was felt that no special allowance for any difference in prices or exchange rate was appropriate. This adjustment reduces slightly the extent of the difference in income tax levels, but does not modify the main conclusions of that analysis.

TABLE 2

COMPARISON OF AVERAGE CANADIAN AND UNITED STATES
PERSONAL INCOME TAXES
(Based on Ontario and Michigan)
Married Taxpayer with Two Dependent Children

Gross Income	Canadian Federal and Ontario Income Taxes	United States Federal and State Personal Income Taxes					
		Michigan Taxpayer			Michigan Homeowner		
		U.S. Income	U.S. Tax Amount	Lower % of Cdn. Tax	U.S. Income	U.S. Tax Amount	Lower % of Cdn. Tax
		Tax			Tax		
\$ 8,000	\$ 1,044	\$ 587	\$ 457	43.77%	\$ 484	\$ 560	53.64%
10,000	1,658	944	714	43.06	809	849	51.21
12,000	2,327	1,332	995	42.76	1,164	1,163	49.98
15,000	3,370	1,979	1,391	41.28	1,725	1,645	48.81
20,000	5,262	3,170	2,092	39.76	2,852	2,410	45.80
25,000	7,434	4,458	2,976	40.03	3,987	3,447	46.37
40,000	14,711	9,766	4,945	33.61	8,977	5,734	38.98
50,000	19,631	14,107	5,524	28.14	12,867	6,764	34.46

Source: Special calculation by Price Waterhouse & Co., with no exchange adjustment. See Technical Notes at the end of this Appendix.

TABLE 3

COMPARISON OF AVERAGE EFFECTIVE RATES OF
CANADIAN AND UNITED STATES PERSONAL INCOME TAXES
Taxes as a Percentage of Gross Income

Gross Income	Married Taxpayer			Single Taxpayer	
	Ontario	Michigan	Michigan Homeowner	Ontario	Michigan
\$ 8,000	13.05%	7.34%	6.05%	21.08%	14.89%
10,000	16.58	9.44	8.09	23.49	16.36
12,000	19.39	11.10	9.70	25.37	17.73
15,000	22.47	13.19	11.50	27.59	19.49
20,000	26.31	15.85	14.26	30.82	22.13
25,000	29.74	17.83	15.95	33.42	24.42
40,000	36.78	24.42	22.44	39.34	31.59
50,000	39.26	28.21	25.73	41.31	35.58

Source: Special calculation by Price Waterhouse & Co., with no exchange adjustment. See Technical Notes at the end of this Appendix.

TABLE 4

**COMPARISON OF MARGINAL RATES,
CANADIAN AND UNITED STATES PERSONAL TAXES**

Gross Income	Married Taxpayer Two Dependents, Homeowner		Single Taxpayer No Dependents	
	Michigan	Ontario	Michigan	Ontario
\$ 8,000	19%	30.72%	23%	33.28%
10,000	21	33.28	26	35.84
12,000	21	35.84	27	35.84
15,000	24	38.40	31	38.40
20,000	27	42.24	36	46.08
25,000	30	46.08	40	46.08
40,000	41	51.20	52	51.20
50,000	47	51.20	62	51.20

Sources: *Proposals for Tax Reform*. Table 2, p. 25 for Ontario. Calculations done by Price Waterhouse & Co. for Michigan. Includes an allowance of a 2 per cent marginal rate for the state personal income tax for all income groups, which is roughly the result after allowing for tax credits.

For example, for single persons with incomes of \$15,000 the marginal rate in Michigan is about 31 per cent, compared to 38 per cent in Ontario, a difference of 7 percentage points in the marginal rates. For homeowners with incomes of \$25,000 the marginal rate is 30 per cent in Michigan, compared to 46 per cent in Ontario, a difference of 16 percentage points in the marginal rates. The Price Waterhouse study concludes: "The tax proposals contained in the Federal White Paper on Taxation have not created the substantial difference between Canadian and United States personal income tax burdens, but if adopted they would appreciably widen the existing gap."

The White Paper Highlights and paragraphs 8.38 and 8.39 in *Proposals for Tax Reform* understate the differences in marginal and average rates of personal income tax between Canada and the United States for the reasons summarized above and developed in detail in the Price Waterhouse Bulletin. The reductions in rates in the United States and the more adequate comparisons contained in this brief indicate that a fuller discussion of these effects is necessary. The *Proposals for Tax Reform* concluded the discussion of the economic effects of Canadian income taxes on the supply of skilled and able people by saying, "We believe that these differences for married persons with higher incomes could best be met in the market by adjusting the pay scales for those individuals or scarce categories who must be retained or attracted against U.S. competition."

As a general rule, it is a sound position to encourage and rely on the price system to make the adjustments to encourage needed adjustments between supply and demand. However, the adjustments through the price system can be slow and difficult under two conditions:

- a. if the extent of the price adjustment required is large; or
- b. if the process of adjusting supply to demand would be slow.

In this particular area, *both* of these conditions are present. At present, real income levels for the total labor force are about 20

per cent less in Canada than in the United States, and the differences would be even greater on an after-tax basis. This is a significant difference, and the combination of lower rates in the United States and the tax rate increases proposed in Canada would widen this gap. If corporations and other organizations were to match real incomes after tax for certain key people to encourage them to move from the United States to Canada, it would create resentment from Canadian staff with similar qualifications and experience. If a general tendency to match U.S. real incomes after tax for all intermediate and senior staff were initiated, it would involve appreciable increases in these costs through a wide part of the Canadian economy. This would create new problems when the real productivity gap for Canada as a whole is as wide as it is, and when the Government is anxious to restrain increases in prices and costs. The nature of the adjustments encouraged by the sentence previously quoted from paragraph 8.39 of the *Proposals for Tax Reform* would create increased costs for organizations and conflicts with the Government's policies on restraining inflation.

Underlying the shortages of key staff in Canada relative to the United States is the smaller proportion of the Canadian labor force and those under 25 who now have, or are getting, university and other post-secondary education. It takes a long time to increase the supply of trained people, especially those with a mixture of education and practical experience. The adjustments will be even more difficult, and will take even longer, if the changes in taxation *accentuate* the size of the adjustments in relative incomes that the price system is trying to achieve. It would be preferable for the Government to *narrow* rather than *widen* the differences in taxes between the two countries. The revenue buoyancy in a growing economy would give the Government much more scope to do this than is implied in the revenue estimates provided in *Proposals for Tax Reform*.

The purpose in introducing this material is to provide additional information to the public and this Committee on the relative tax position of individuals in the two countries. The comparisons indicate that the differences in taxes can play an important part in the decision as to whether particular individuals would work in Canada or the United States. This is particularly so when the number with the desired education and experience is small and when they may be well known in both countries.

In commenting on this question, the *Proposals for Tax Reform* states:

A second issue is to what extent Canadian income taxes affect the ability of Canada to retain able and highly trained Canadians who could emigrate to the U.S., and to attract skilled and able persons from the U.S. or elsewhere. When the Royal Commission considered this matter it concluded: "We are skeptical that tax factors have been a major factor in emigration."³²

³²*Proposals for Tax Reform*, paragraph 8.38, p. 91.

It is true that at the time of the Royal Commission Report, differences in Canadian and U.S. personal income taxes were not large. Since then, however, U.S. taxes have been reduced, while in Canada the marginal and average rates on family incomes of \$10,000 to \$30,000 would be higher if the White Paper is implemented, rather than lower as favored by the Royal Commission. Furthermore, subsequent study has made clearer the emerging demand pressures for key personnel in Canada. The earlier summary of the differences in tax rates and the fuller presentation in the Price Waterhouse Bulletin indicate that under the White Paper's proposals, tax differences would become a much more important factor in the net flows of trained people than they ever have been before.

TECHNICAL NOTES TO TABLES 2 AND 3

These notes summarize the basis of the income tax calculations used in these comparisons.

It has been assumed, for purposes of Table 2, that the taxpayer is married, has two dependent children under the age of 16, and derives his entire income from employment. For Canadian tax purposes, it has been assumed that the taxpayer is resident in Ontario, and Ontario income tax is included in total Canadian income tax; Canadian federal tax has been based on the White Paper proposals, and reflects the increased personal exemptions and the revised rate schedule (after full reduction in rates) as proposed in the Paper. For United States tax purposes, it has been assumed that the married taxpayer files a joint return. United States tax calculations have been based on a Michigan resident, and the related state income tax has been included in total United States income tax; United States federal tax has been based on the provisions (after full implementation in 1973) of the United States Tax Reform Bill of December 30, 1969, and reflects the increased personal exemptions and termination of the 10 per cent surtax as enacted by that Bill.

Neither Canada Pension Plan (\$83) nor United States Social Security contributions (\$374 in 1969) have been included in the related income tax totals for the reasons stated in Appendix D, and Canadian and United States dollars have been taken at par of exchange in arriving at the comparative tax burdens.

For Canadian tax purposes, deductions used in computing taxable income, such as for retirement savings plan contributions and charitable donations, have been based on statistical information in respect of the 1967 taxation year (the latest year available) compiled from "Taxation Statistics, 1969 Edition" (published by the Department of National Revenue); recognition has also been given to the \$150 allowance for employment expenses, as proposed in the White Paper. For example, these statistics indicate that the average Canadian taxpayer in selected income brackets would claim the following deductions:

	Total Income				
	\$8,000	\$12,000	\$15,000	\$25,000	\$50,000
<i>Deductions:</i>					
Retirement savings plans	\$243	\$383	\$483	\$833	\$1,183
Donations	100	110	160	350	750
Employment expenses	150	150	150	150	150
Other	40	35	30	50	100
	<u>\$533</u>	<u>\$678</u>	<u>\$823</u>	<u>\$1,383</u>	<u>\$2,183</u>

For United States tax purposes, deductions used in computing taxable income, such as for medical expenses, contributions, taxes and interest, have been based on

statistical information in respect of the 1967 taxation year compiled from "Statistics of Income, 1967" (published by the Internal Revenue Service) and "Federal Tax Guide Reports" (published by Commerce Clearing House, Inc.). These statistics reveal that the average United States taxpayer who itemizes his deductions (over 77 per cent of all United States taxpayers with incomes in excess of \$10,000 did itemize their deductions in 1967 in lieu of claiming the standard deduction) would claim the following deductions in selected income brackets:

	Total Income				
	<u>\$8,000</u>	<u>\$12,000</u>	<u>\$15,000</u>	<u>\$25,000</u>	<u>\$50,000</u>
<i>Deductions:</i>					
Contributions	\$200	\$300	\$350	\$ 600	\$1,000
Interest	500	700	750	1,000	1,200
Taxes*	450	700	700	1,200	2,000
Medical.	350	300	400	600	800
	<u>\$1,500</u>	<u>\$2,000</u>	<u>\$2,200</u>	<u>\$3,400</u>	<u>\$5,000</u>

*Includes average state income taxes. For purposes of the tax calculations herein, a portion of this amount has been deleted, and the actual Michigan income taxes substituted therefor.

In estimating the taxable income of the average United States homeowner, it has been assumed that the taxpayer owns a home valued at between \$20,000 and \$75,000 (depending on his level of income), that he carries a 7½ per cent mortgage thereon in a principal amount equal to one-half of the home's value, and that he incurs annual property taxes amounting to 2 per cent of the home's value. As an example, it has been assumed that the average United States homeowner residing in the state of Michigan, in selected income brackets, will claim the following deductions in arriving at his taxable income:

	Total Income				
	<u>\$8,000</u>	<u>\$12,000</u>	<u>\$15,000</u>	<u>\$25,000</u>	<u>\$50,000</u>
(Value of home)	<u>\$20,000</u>	<u>\$30,000</u>	<u>\$35,000</u>	<u>\$50,000</u>	<u>\$75,000</u>
<i>Deductions:</i>					
Contributions	\$ 200	\$ 300	\$ 350	\$ 600	\$1,000
Mortgage interest	750	1,125	1,313	1,875	2,813
Taxes—					
Property	400	600	700	1,000	1,500
State income (actual)	23	104	172	392	977
Other taxes	213	253	279	336	466
Medical.	350	300	400	600	800
	<u>\$1,936</u>	<u>\$2,682</u>	<u>\$3,214</u>	<u>\$4,803</u>	<u>\$7,556</u>

Appendix E

ELIGIBLE EXPENDITURE BASE FOR “EARNED DEPLETION”

Price Waterhouse & Co.*

Under the present provisions of the Income Tax Act, an incentive depletion allowance generally equal to one-third of net mineral production income is permitted as a deduction in computing income for corporate tax purposes. The federal Government, in its *Proposals for Tax Reform* released on November 7, 1969, has suggested that this mineral depletion allowance, while continuing to be available, will in the future be subject to restrictions related to a taxpayer's expenditures on exploration, on the development of new Canadian mines, and on certain fixed assets for such new mines. (Such exploration, development and new mine asset costs, which would serve as a basis for depletion claims under the White Paper proposals, are called “eligible expenditures” in this memorandum.)

A concept of “earned depletion” would therefore be introduced by the White Paper as opposed to the present percentage depletion system with the depletion allowance claimable being one-third of a mineral operator's “eligible expenditures” not heretofore used to “earn” depletion. The maximum depletion allowance claimable under the new provisions, however, would continue to be the same as the present depletion allowance of one-third of net production profits.

During a transitional period, taxpayers will be permitted to claim depletion allowances, as permitted under our present Income Tax Regulations, with respect to all mineral properties owned by them on November 7, 1969 for the first five years of the new tax system¹. Following the end of this transitional period, the deduction in respect of depletion would become subject to the new limitation outlined above. All “eligible expenditures” made by taxpayers after November 7, 1969, however, could be used to “earn” depletion after the transitional years.

It is not the purpose of this memorandum to comment upon the actual rate of depletion offered or on the validity of the proposed change from a percentage depletion basis to an “earned depletion” basis. Rather, this memorandum will seek to consider the basis of

*This memorandum has been prepared by Price Waterhouse & Co., Toronto at the request of The International Nickel Company of Canada, Limited.

¹*Proposals for Tax Reform*, paragraph 5.42. No percentage depletion would be permitted after the introduction of the new system on properties acquired after November 7, 1969.

the proposed earned depletion—the “eligible expenditures” upon which the new depletion system will be based.

“Earned Depletion” Base Contrasted With Section 83A Expenditures

The White Paper proposes² that the “eligible expenditure” base of a mining company that could be used to “earn” depletion allowances should be its expenditures on “exploration for or development of mineral deposits in Canada,” and on spending on mine buildings, machinery and equipment³ for a new mine.

The tax treatment of exploration and development expenses is extensively dealt with under Section 83A of the present Income Tax Act, and such expenses are frequently referred to as Section 83A expenses. Under various subsections of Section 83A certain persons, including operators of mineral resources, may deduct the aggregate of the prospecting, exploration and development expenses incurred by them in searching for minerals in Canada. Expenses of this nature incurred by a mining company in searching for, and opening a new mine are deductible under this Section regardless of whether a taxpayer has an existing mine in operation. Drifting, stoping and other mining expenses incurred in connection with the current operation of an existing mine are, however, normally regarded as deductible as current operating expenses or, in the case of more permanent underground workings, by way of capital cost allowances under Class 12 of the Regulations to the Income Tax Act.

Deductible expenses for metal mining companies under Section 83A do not presently include payments in respect of the purchase of a property, right, license or privilege to explore for or take metallic minerals, nor do they include the cost of any buildings or equipment for which depreciation may be claimed under separate sections of the Income Tax Act. “Eligible expenditures” for the new depletion provisions similarly would not include any costs of purchasing mining properties. However, they would include the cost of certain types of mining buildings and equipment acquired in connection with the start-up of a new mine.

We understand that there would be a further important difference between the “eligible expenditure” base and Section 83A expenses, in that mining development work performed in connection with the extension of existing mines would not be included in the base. In many cases, substantial capital costs incurred by mining companies in extending their existing workings, in exploring for minerals through underground searches conducted from existing mines, and in substantial new developments in existing mines have been considered as “development expenses” under the provisions of Section 83A. While the words of the White Paper itself may seem to indicate that all mining development expenses would be included in the “eligible expenditure” base, we understand that officials of the Department of

²*Proposals for Tax Reform*, paragraph 5.40.

³Of the sort normally included in Class 10, *Proposals for Tax Reform*, paragraph 5.29.

Finance have indicated that it was not intended that development costs associated with existing mines should be included in the "eligible expenditure" base but only development costs relating to new mines.

The "eligible expenditure" classification proposed in the White Paper would include total expenditures on buildings, mining machinery and equipment acquired for a new mine, but only to the extent that such amounts are included in Class 10 of the capital cost allowance schedules. It would appear on reviewing the proposals as presented in the White Paper that expenditures made by mining companies on items such as refineries for a new mine, roadways, housing and other assets related to new mine townsites, and main shafts and haulageways after a new mine commences operation have not been explicitly dealt with in the White Paper in describing the "eligible expenditure" base. Because such items do not fall within Class 10, we have assumed that such items are not to be included. Furthermore, expenditures on the expansion of the processing and other facilities of existing mines will also not qualify as "eligible expenditures" for depletion purposes because they were not incurred in connection with the opening of a new mine.

"Eligible Expenditures" and Risk

The Government, in reviewing the taxation of the mining and petroleum industries, has concluded that the tax system should continue to offer some form of depletion as an incentive to these industries.⁴ A review of the commentary in the White Paper with respect to a depletion allowance indicates that a main purpose in the Government's proposal with respect to depletion is evidently to relate the amount of depletion claimable by mineral operators to the amount expended on their more risky capital expenditures on exploration and new mine development in Canada.⁵ If one accepts this as an appropriate objective of the depletion proposal (and it should be noted that there are other possible objectives of a system of depletion allowances), there would still seem to be no explanation for the significantly different treatment proposed for exploration costs and outlays associated with new mine development and for other amounts which a mineral company must permanently commit in order to carry out its mining activities.

Mining, as an activity, represents an integrated business, and many of its capital expenditures (whether for new mine development, mine expansion or establishment of processing facilities) involve important degrees of risk. To the extent that any particular mine fails to produce grades or quantities of ore anticipated, to the extent that there may be fluctuations in the world market price for minerals, to the extent that mining companies fail to discover new ore bodies, and to the extent that technological change influences demand in respect of particular metals, all capital expenditures made by mining companies—whether for exploration, new mine development, mine expansion,

⁴*Proposals for Tax Reform*, paragraph 5.24

⁵*Proposals for Tax Reform*, paragraph 5.40.

or processing facilities—may be subject to an essentially equal degree of risk. One of the important characteristics of the mining industry is that expenditures made by companies in the industry on all aspects of the development and expansion of mining facilities do not, in most cases, lead to the creation of assets which have a substantial salable value independent of the mining enterprise with which they are connected. In this sense, most development and expansion costs made by a mining enterprise are equally “at risk”, since they have few alternative uses and the recovery of these costs is dependent on the success of the whole mining venture in question.

From an accounting viewpoint, while different portions of a mining company’s total investment in mining and processing assets may have different useful lives, most of such assets may have little utility beyond the economic life of a mine, and accounting procedures adopted to systematically amortize mine asset costs are drawn up with this basic fact in mind.

“Eligible Expenditure” Base and Expenditures on Processing Assets

In formulating its proposals for the new basis of computing depletion and other mining incentives, the Government recognized:

- a. “that the exploration for and development of mines and oil and gas deposits involve more than the usual industrial risks and the scale of these risks is quite uncertain in most cases,” and
- b. “that the exploration for and development of mineral deposits continue to provide special benefits to Canada and to various provinces by creating or maintaining highly productive industry in areas other than those where rapid urban and industrial growth are already occurring as a result of both private and public efforts.”⁶

In making these two observations the Government concluded that special incentives are still required to encourage the mineral industry. With regard to recognition of the mineral industry’s contribution to the development of Canada, it would seem that the mere exploration for and location of minerals produce no real growth for the country. Rather, the mining, crushing, concentrating, smelting, refining and other activities carried out following the location of a mineral resource provide the employment, the economic return and all the other associated benefits that are important to the economy of Canada. Expenditures on exploring, on developing a “new mine” and purchasing its plant do not, in isolation, provide a true measure of the extent of a mining company’s commitment to the finding and exploitation of mineral resources in Canada, or of the benefits to this country that may arise from the exploitation of such resources.

The processing of minerals in Canada is an activity which provides large and growing returns to the total Canadian industry. The importance of processing to Canada was highlighted and emphasized in the 1969 budget address of the Honorable Charles MacNaughton, Treasurer and Minister of Economics of the Province of Ontario. In

⁶*Proposals for Tax Reform*, paragraph 5.24.

that address, Mr. MacNaughton pointed out that the province was adopting new approaches under its Mining Tax Act whereby mining companies in the province would be encouraged to process minerals in Canada. Ontario took the first step in this direction by proposing certain incentives related to the Canadian processing activities of mining companies; other provinces have also raised this issue. The question then arises as to whether the limitation of the proposed new federal depletion incentive to exploration costs and expenditures on the development of "new mines" is consistent with the desire to encourage the maximum possible processing of Canadian ores in Canada. The incentives provided in the White Paper relate basically only to expenditures on finding new minerals and on developing completely new properties to the production stage. No corresponding incentives are granted with respect to expenditures on important processing, refining and other related activities that may be carried on by mining companies in Canada, even those that are established in connection with new mines.

Possible Distortion of Expenditures

The White Paper's proposals with respect to the earned depletion base would seem to us to result in a degree of economic distortion with regard to the expenditure pattern of the extractive industries. Mining machinery and other capital assets associated with a mining operation do not last forever and, in fact, are subject to a rather rapid degree of deterioration and, during today's era of rapid technological change, obsolescence. By way of example, if it is assumed that mining machinery with a useful life of approximately 20 years is acquired during the period that a new mine is being opened, the related cost of the machine would be regarded as an "eligible expenditure" in respect of which depletion allowances could be "earned." On the other hand, if a decision was made that it would be more prudent and economical to acquire a less costly machine with a useful life of approximately—say—10 years and subsequently replace it with another machine of possibly superior design, the "eligible expenditures" of the mine for the purpose of "earning" depletion allowances would include only the cost of the first machine. Although this is a fairly simple example, many similar situations can be used to illustrate that confining the base for depletion allowance to only one category of mining expenditures would introduce economic distortion in choosing between different means of achieving essentially the same objective.

The expansion of an existing mine may represent as much of a commitment of funds and acceptance of risk as the original establishment of the mine itself. It is quite common in establishing a mine to limit total expenditures in the early stages until such time as accurate determination can be made of the extent of underground ores. Subsequently, to the extent that the initial limited operation verifies the existence of underground bodies warranting further exploration, the mine would be expanded into a larger development. The expansion of the operation, although carried out one or two years after the

initial mine opening, is usually contemplated at the time of establishment of the initial mine and is frequently taken into account in determining whether it is worthwhile to commence mining development at all. In circumstances such as these, distinguishing between the tax treatment of development and new asset costs associated with the original mine and those associated with the expansion of the mine may result in undesirable distinctions which can distort expenditure patterns of such an operation. As indicated in the foregoing remarks, the expansion of the mine may well have the same favorable economic and other effects as the establishment of a new mine.

The specific rules proposed by the Government would lead to the exclusion from "eligible expenditures" of many important amounts of costs incurred in connection with new mining ventures. By delaying expenditures on processing assets until after the extent, the grades and characteristics of the ore body have been fully established, it is possible to design more economical treatment plants and also ease financial pressures associated with the development of the mine. Such a procedure delays certain of the processing and treatment expenditures until several years after the opening of the actual mine, and this would presumably prevent these important costs from qualifying as "eligible expenditures" under the Government's proposed rules, even if they would otherwise have qualified.

"Eligible expenditures" on development and mine assets are to include specified expenditures on "new" mines only. No details are provided, however, with respect to what the Government would consider to be a "new mine." In this respect we note that substantial practical difficulties have been experienced in the past in distinguishing between a new mine and an extension of existing workings.

Summary

We have reviewed in this memorandum some of the implications relating to the particular choice of "eligible expenditure" base adopted in the White Paper as the foundation for the new depletion allowance system for the mining industry. This review would indicate that the sharp distinction made in the White Paper between its specified "eligible expenditures" and other mining development costs does not seem to be in accordance with any clearly defined economic, business or accounting considerations. The introduction of this difference in treatment will in our view lead to different tax treatment being afforded essentially similar expenses and may result in some distortion in expenditure patterns in the industry.

Mining expenditures made on the expansion of existing mines, the establishment of new processing complexes and their expansion and on necessary infrastructure expenses such as townsites and transportation would not be included in the base used to provide incentive depletion provisions. All such expenditures, however, may well carry with them important risks to the mining company concerned, and benefits to the community.

It is beyond the scope of these comments to attempt any overall

critical analysis of the White Paper's proposals with respect to mineral depletion allowances, and in any event it is obvious that tax policies must be determined from a multitude of considerations, only some of which have been referred to in this memorandum. It would seem, however, that the particular distinction made in the White Paper between mineral expenditures falling within and without the "eligible expenditure" base is one that is not justified in the White Paper itself.

PRICE WATERHOUSE & CO.

Toronto, Ontario
April 15, 1970

Appendix F

TAX TREATY PROBLEMS WITH DEVELOPING COUNTRIES

Price Waterhouse & Co.*

Under the present Canadian tax system a Canadian company is not taxed on a dividend received from a "controlled foreign corporation"—a company in which the Canadian corporation owns at least 25 per cent of the voting share capital. The Government's *Proposals for Tax Reform* proposes that in the future this exemption from taxation be restricted to dividends received from controlled foreign corporations operating in a country with which Canada has concluded a tax treaty. Dividends received from a controlled foreign corporation in a non-treaty country would be included in income, and credit would be given for the applicable underlying corporate taxes paid in the foreign jurisdiction and withholding taxes levied on the dividends remitted to Canada. Under the White Paper's proposals, the existence of a tax treaty would determine whether dividends received by a Canadian parent company from a controlled foreign corporation should be subject to tax in Canada.

Canada's present international treaties are primarily confined to the industrialized nations.¹ It is the conclusion of this memorandum that Canada will find it difficult to negotiate tax treaties with many underdeveloped countries. If this conclusion is correct the White Paper's proposal to restrict the dividend exemption to treaty countries could discourage Canadian corporations from building up business operations in developing countries and in any event would serve to hamper the expansion or even continued existence of Canadian-owned businesses in countries with which we do not have tax treaties in competition with corporations owned by residents of other countries.

Methods of Taxing International Income

As an introductory comment, it can be observed that most countries of the world adopt one of the following three methods to tax the

*This memorandum has been prepared by Price Waterhouse & Co., Toronto, at the request of The International Nickel Company of Canada, Limited, and in collaboration with Price Waterhouse & Co., New York.

¹The countries with which Canada presently has tax treaties are Australia, Denmark, Finland, France, Japan, the Netherlands, New Zealand, Norway, South Africa, Sweden, Trinidad and Tobago, the United Kingdom, the United States and West Germany.

direct investment income received by their corporations in the form of dividends from subsidiaries abroad:

1. *Exemption Method*—Under this method, typically followed by a number of European countries, dividends received by domestic corporations from foreign subsidiaries are virtually completely exempt from domestic tax at the corporate level. This is also the method currently followed by Canada, and the White Paper proposes that it be continued but only for dividends from controlled foreign corporations in countries with which Canada has a tax treaty.

2. *Tax Credit Method*—Under this approach, followed by the United States, the United Kingdom and Japan among others, domestic companies receiving dividends from subsidiaries abroad are required to include these dividends in their taxable income, but receive full credit for the withholding taxes and underlying corporate income taxes levied on the income out of which the dividends arose. For example, a foreign subsidiary might earn \$100 in before-tax income, on which it might pay \$40 in foreign income taxes leaving an after-tax profit of \$60. If this profit were entirely distributed as a dividend to the parent company, but subject to a withholding tax of 10 per cent (or \$6), the parent company would actually receive \$54 as a cash dividend. However, it would be required to include \$100 in its domestic income, this being the amount of before-tax profits out of which the dividend was paid, and could then deduct as a credit against the domestic tax on such foreign income the total foreign taxes of \$46 (\$40 corporate income tax and \$6 withholding tax) levied on such income. The tax credit approach inevitably involves many complications with respect to determining foreign income and foreign taxes on a basis acceptable for tax purposes in the parent company's country, and in identifying income out of which the dividend was paid.

3. *Tax-sparing Approach*—This method is usually adopted as a modification of the tax credit approach described above. Under the tax-sparing system, dividends received by domestic corporations from foreign affiliates are generally taxable, but credit is given not only for the foreign taxes actually paid by the foreign affiliates, but also for any foreign taxes that have been forgiven as a result of some tax incentive provision in the laws of the foreign countries. In the example given in (2) above, if the foreign corporation income taxes of \$40 had not actually been payable because of some incentive tax reduction granted in the foreign country, under the tax-sparing approach the foreign tax credit in respect of that income in the country of the parent company would have been computed as though that tax had in fact been paid. The effect of a tax-sparing approach is to allow the investor to retain, at least at the corporate level, the benefits of tax incentives granted by the foreign country. In one sense, the tax exemption method is merely the ultimate expansion of a tax-sparing approach.

As mentioned in the White Paper, all of the above approaches have advantages and disadvantages. The exemption system heretofore used by Canada allows Canadian corporations to compete abroad in foreign markets with competitors who may be subject only to taxes in

the country in which they operate, and not to any further taxes in the country in which their home base is located. If Canada were to impose any additional taxes on Canadian corporations operating abroad through subsidiaries, Canadian interests abroad would be at a competitive disadvantage with other companies based in countries which do not impose additional taxes on foreign income, either because they have adopted the tax exemption approach as discussed above, or for other reasons.

Present and Proposed Canadian Treatment of Inter-corporate Dividends

Section 28(1)(d) of the Canadian Income Tax Act provides for the exemption of dividends received by a Canadian corporation from a foreign corporation in which the Canadian company owns more than 25 per cent in terms of voting control. Except for the required minimum holding, this exemption is a modified extension of the current exemption of domestic inter-company dividends, which on the one hand is not dependent on a minimum participation in the equity capital of the distributing corporation, but on the other hand requires that the latter be taxable in Canada.

The purpose of the exemption of dividends from direct foreign investments is, in part at least, to avoid the multiple taxation of corporate profits at the corporate level by preventing the taxation of the income in question, first to the corporation earning the profits and then to the intermediate holding or parent company.²

The White Paper would restrict the exemption of domestic inter-company dividends. In general, such dividends would remain exempt if received by a public ("widely held") corporation, except insofar as the distributing corporation does not have sufficient "creditable tax" available to allow the dividend to be regarded as having been paid out of fully taxed income.³ The exemption of foreign inter-company dividends, on the other hand, would be terminated after a transitional period except for dividends received from a foreign corporation (at least 25 per cent owned) resident in a country with which Canada had concluded a tax treaty.⁴ Where the exemption becomes inapplicable, it would be replaced by a foreign tax credit, both for the foreign withholding tax and for a proportionate part of the tax paid by the foreign corporation on the profits supporting the dividend distribution.⁵

Treatment of Inter-company Dividends in Other Industrialized Countries

The great majority of industrialized countries provide in one form or another for full exemption or at least for greatly reduced taxation of domestic inter-company dividends. Most of these countries also extend these privileges to foreign inter-company dividends, either

²*Proposals for Tax Reform*, paragraph 4.52.

³*Proposals for Tax Reform*, paragraphs 4.57 and 4.59.

⁴*Proposals for Tax Reform*, paragraph 6.15. The exemption would be limited for the "passive income" of controlled foreign corporations—see also 6.20 and 6.21.

⁵*Proposals for Tax Reform*, paragraphs 4.48 and 6.17.

generally or in favor of investments representing a substantial participation in the equity capital of the foreign corporation. Thus, a Swiss corporation is not taxed (under the federal law of Switzerland or that of most cantons) on dividends received from a domestic or foreign corporation whose share capital it owns to the extent of at least 20 per cent or 2 million Swiss francs in value. A Netherlands corporation is not taxed on domestic dividends if it owns at least 25 per cent of the share capital of the distributing corporation. This privilege is extended to foreign inter-company dividends, provided only that the distributing corporation is subject at its domicile to an income tax that is more or less comparable to the Dutch corporate tax. A French corporation is subject only to a minimal tax on dividends from either domestic or foreign corporations in which it owns as little as 10 per cent of the share capital. Similarly, an Italian corporation is liable for the income tax on movable wealth (*ricchezza mobile* tax) but not the company tax (*imposta sulle societa*) on inter-company dividends regardless of the origin, domestic or foreign, of the distribution.

Other countries exempt foreign inter-company dividends under tax treaties, in accordance with their general policy of avoiding or mitigating international double taxation by excluding certain income from the tax base for purposes of domestic taxation. This method is followed by the Federal Republic of Germany and Sweden which, subject to certain conditions, do not tax their corporations on domestic dividends in the case of a "substantial" (25 per cent or greater) participation and extend the same privilege under tax treaties to foreign inter-company dividends.

The countries that rely on the foreign tax credit as the principal device for the avoidance of international double taxation do not normally extend their domestic exemption privileges to foreign dividends. However, the domestic taxation of dividends received by corporations from foreign direct investments is substantially softened by allowing a foreign tax credit with respect to the foreign withholding tax on the dividend as well as a proportionate part of the foreign corporate tax levied on the income out of which the dividend was paid.

Encouraging Canadian Investment in Canada

The White Paper points out that Canada is presently a substantial capital-importing nation.⁶ It refers to the fact that the capital requirements of the country are expected to exceed available domestic savings in the foreseeable future, and to the existing high degree of foreign ownership of and control over Canadian industry. The White Paper concludes that it would clearly be inappropriate at this time to encourage the export of investment capital that is needed domestically.⁷

The White Paper states that its proposals are not designed either to provide an incentive for foreign investment by Canadians or to place a barrier in the way of such investment.⁸ This claim of strict neutrality

⁶*Proposals for Tax Reform*, paragraph 6.9.

⁷*Proposals for Tax Reform*, paragraph 6.8.

⁸*Proposals for Tax Reform*, paragraph 6.8.

with respect to the foreign investments of Canadians rests on two foundations that may be difficult to reconcile in all circumstances: domestic tax neutrality and tax neutrality at the foreign place of operations. Domestic tax neutrality, which is the rationale underlying the foreign tax credit system, means that a dollar earned abroad should not in general bear a higher or lower overall tax burden (at least as far as the investor's home country is concerned) than a dollar earned domestically. Tax neutrality at the place of operations, which is the reason used to support the exemption method, means that the investor's home country should put its residents or corporations in a position of competitive equality vis-à-vis local investors in the host country and investors from third countries operating there. Most countries follow one or the other method, at least with respect to one and the same category of income. The White Paper undertakes to apply the first method to non-treaty countries and the second to countries with which Canada has entered into a tax treaty.

Expansion of Canadian Treaty Networks

The Government recommendations must be examined in the context of the contemplated extension and improvement of tax treaties between Canada and other countries. The assumption appears to be that Canada can, within a few years, have tax treaties with all countries with which it maintains substantial economic relations. This expectation seems unduly optimistic both in view of the traditional slowness of the treaty-making process and, in particular, the disinclination of developing countries to conclude such treaties.

An analysis of 38 tax treaties between developed and developing countries is attached to this memorandum as an exhibit. This analysis probably covers more than half of the treaties that exist between developed and developing countries, but these treaties are only a small fraction of all bilateral tax conventions, notwithstanding the fact that the economically underdeveloped nations represent at least two-thirds of all countries of the world. The treaty pattern developed between industrialized nations is not attractive to developing countries because it requires them to sacrifice urgently needed revenue without receiving significant benefits in return. The more backward a developing country is, the more unrealistic becomes the expectation of a substantially reciprocal flow of investments, which is the foundation of tax treaties between industrialized countries. Considering what limited incentive there is for a developing country to enter into a tax treaty, it follows that a tax benefit which an industrialized country is willing to extend only under a treaty may never apply to investments in developing countries.

The experience of the United States, which has an extensive network of international tax treaties, is significant. Except for the extension of the treaties with the United Kingdom, Belgium and the Netherlands to certain overseas territories of those countries, the 22 general income tax conventions of the United States that are presently in effect include only one treaty with a developing country (Pakistan). Two treaties with developing countries (India and the United Arab

Republic) were withdrawn, one treaty (with Honduras) was terminated, three treaties (with Brazil, Israel and Thailand) were not and are not expected to be ratified, and one treaty (with the Philippines) has not been ratified to date, although it was signed in 1964. A new treaty with Trinidad and Tobago was signed in January 1970 but is in the process of ratification.

Tax Incentives in Developing Countries

Many of the developing countries of the world offer tax incentives or tax concessions to investors who establish new enterprises within their boundaries. In some cases these incentives are available to corporations establishing new businesses in designated areas, while in other cases they are limited to certain specified types of enterprise or activity that are considered worthy of encouragement. The incentives may consist of a partial or complete exemption from the normal income taxes which would otherwise be payable in the developing country. A number of developing countries feel that the use of such incentives is an important means of enabling them to attract and retain new industries in order to build up their economies.

Of course, a developing country providing such incentives normally wishes to ensure that the incentive will provide benefits to the foreign investor (in order to provide the inducements to take the action the developing country desires) and will not be taken in the form of higher taxes imposed in the home country of the investor. An unfortunate side effect of the tax credit approach to the taxation of dividends from developing countries is that frequently the incentives provided by those countries to induce needed foreign investment can be completely offset by higher taxes on the income when remitted to the investor's country. If the developing country learns that its tax incentives are being taxed away in this manner it may well withdraw these incentives since they then only serve to benefit the foreign treasuries and not to provide inducements to investment.

Position of Developing Countries on Tax Treatment

As previously pointed out, the main weakness of the regular foreign tax credit system, from the viewpoint of the developing countries, is that it channels the benefits of tax exemptions or reductions, which practically all developing countries extend, from the foreign investor to the treasury of his home country, which is least in need of this revenue. In addition, the foreign tax credit is no longer the reliable instrument for the avoidance of double taxation that it may have been in its beginnings when tax systems were relatively simple, tax rates were low and large-scale foreign investments outside colonial territories were comparatively rare. At the present time, and especially since the advent of the large multinational corporation operating over wide areas, questions such as the geographical source and proper allocation of international income present problems that were not even known a few decades ago, and inconsistent determinations of taxable income by different jurisdictions create an increasing number of double taxation cases that are only rarely resolved in a satisfactory

manner under the available treaty procedures.

The tax-sparing credit preserves the benefits of tax concessions to the investor, for whom they are intended, and thus represents an improvement over the regular foreign tax credit. Otherwise, the tax-sparing credit is not particularly well suited to promote investments in developing countries either from the viewpoint of these countries or the investor. Without exception, the industrialized countries grant the tax-sparing credit only by treaty in order to retain control over the incentive and to prevent its abuse by developing countries. This factor by itself limits the application of the credit. In addition, the tax-sparing credit is as temporary as the tax concessions of the developing country which it is designed to preserve. At the time these concessions expire, the tax-sparing credit is replaced by the regular foreign tax credit with all the attendant disadvantages summarized above. Experience has shown that the developing countries tend to increase their income tax rates to the level of the major capital-exporting countries applying the foreign tax credit. As a result, the latter countries will not collect any substantial amount of tax after the tax holiday in the developing country has ended.

Exemption of dividends from controlled foreign corporations in developing countries is the prevalent rule which the industrialized countries of Europe apply either unilaterally or under tax treaties. This method puts the investor in a position of tax equality in the country of operations, which should be the relevant consideration, and removes tax obstacles to the repatriation of profits or their reinvestment in other foreign ventures. The exemption method has the additional advantage of avoiding conflicting determinations of taxable income because the investor deals with only one taxing jurisdiction.

Summary

The White Paper includes significant incentives designed to encourage Canadian investment in Canada. The most important proposal in this area is the partial integration of personal and corporate income taxes. If this recommendation is fully implemented, distributions by a closely held Canadian corporation out of taxable income earned in Canada will not be taxable to individual Canadian shareholders, and distributions by a public corporation will be taxable only to shareholders in the higher tax brackets.⁹

This proposal is aimed deliberately at stimulating investment not simply in Canadian corporations as such, but in Canadian corporations with Canadian operations.¹⁰ On the other hand, the Government recognizes that Canadian business is often compelled to go abroad in search of sources of supply and foreign markets. It is also aware that Canadian corporations in this position would find it hard to compete on the international scene if they were subject to taxes

⁹*Proposals for Tax Reform*, p. 49 at 4.25, p. 51 at 4.37.

¹⁰*Proposals for Tax Reform*, p. 72 at 6.10.

more onerous than those which apply to their competitors from other countries.¹¹

The White Paper states that the use of bilateral tax treaties as a means for alleviating international double taxation has the unfortunate side effect of discriminating against investments in non-treaty countries.¹² Any comparison of the number of tax treaties concluded between developed countries on the one hand and between developed and developing countries on the other will demonstrate that most developing countries of the world—both the newly emerging states of Africa and Asia and the longer-established countries of South America—are typically reluctant to sign tax treaties with other countries. Discriminating against investments in such countries because of their unwillingness to enter into bilateral tax conventions will not help the industry of the developed country, especially if the developing country is the source of indispensable raw materials.

Although the White Paper does not expressly equate non-treaty countries with tax haven countries, it clearly points in this direction by describing the purpose of the partial repeal of the dividend exemption as a countermeasure to efforts at artificial reduction of the tax burden on tax haven income.¹³ It is submitted that this assumption is not necessarily warranted and that tax haven abuses can be effectively curtailed through the adoption of the “passive income” provisions discussed in the White Paper,¹⁴ or by alternative means. If the proposals of the White Paper in reference to foreign dividends are enacted, their effect will be to discourage Canadian investments in developing countries, to the possible detriment of those countries as well as the Canadian economy.

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Toronto, Ontario
April 15, 1970.

¹¹*Proposals for Tax Reform*, p. 72 at 6.9.

¹²*Proposals for Tax Reform*, p. 72 at 6.5.

¹³*Proposals for Tax Reform*, paragraph 6.15.

¹⁴*Proposals for Tax Reform*, paragraph 6.21.

Exhibit

TREATMENT OF INTER-COMPANY DIVIDENDS UNDER TAX TREATIES BETWEEN DEVELOPED AND DEVELOPING COUNTRIES

A brief survey of the treatment of inter-company dividends under tax treaties that now exist between industrialized and developing countries may be useful in illustrating the problems of attempting to negotiate such treaties and in summarizing the variety of approaches adopted. The following survey covers 38 tax treaties between developed and developing countries that are presently in effect. The relief methods applied by the developed countries under these treaties consist of the foreign tax credit, the tax-sparing credit, and the exemption of foreign dividends. Because of the differences in tax concessions offered by the developing countries, the treaties can be classified into six groups, as follows:

<i>Relief Extended by Developed Country</i>	<i>Treatment of Dividend by Developing Country</i>
(1) Foreign tax credit (including deemed paid credit in some cases)	Reduction of withholding tax
(2) Tax-sparing credit	Exemption or reduced taxation
(3) Tax-sparing credit	Full taxation
(4) Exemption	Full taxation
(5) Exemption	Reduced taxation
(6) Exemption under rules applying to domestic inter-company dividends	Exemption

Method 1: Foreign tax credit at investor's domicile and reduction of withholding tax in host country

This method is not frequently used outside the countries which employ the foreign tax credit as the principal statutory device for the avoidance of double taxation. It applies to all foreign dividends under the treaties of the United Arab Republic with Austria (1962), the Federal Republic of Germany (1959), Finland (1965), Norway (1964) and Sweden (1958), and the treaties of Pakistan with Denmark (1961) and Japan (1959). The treaties of the Federal Republic of Germany with Ceylon (1962) and Pakistan (1958-1963) apply this rule unless the German company owns at least 25 per cent of the shares of the Ceylonese company or more than 25 per cent of the shares of the Pakistani company; in those cases, the dividends are exempt at the shareholder's residence.

Method 2: Tax-sparing credit at investor's domicile and exemption or reduced taxation of dividend in host country

This method applies under the treaties of Japan with Malaysia (1963), Singapore (1961) and Thailand (1963); the treaties of the United Kingdom with Pakistan (1961)¹ and Israel (1962), between Sweden and Israel (1959), and the treaties of the Philippines with Denmark (1966) and Sweden (1966).

The treaty between the United Kingdom and Israel and the treaties of Japan with Malaysia and Thailand extend the tax-sparing credit to the tax of the foreign corporation on the profits from which the dividend was paid.²

Method 3: Tax-sparing credit at investor's domicile and full taxation of dividend in host country

This method is followed under the treaties of Israel with Finland (1965) and the Federal Republic of Germany (1962)³ and the treaty between India and Japan (1960)

¹Provided that the British company is a public company owning more than 50 per cent of the voting shares of the Pakistani company and that the dividends are allocable to industrial undertakings conducted by the Pakistani company.

²Under the treaties of Japan with Malaysia and Thailand, the tax-sparing credit for the underlying tax of the foreign corporation is available only if inter-company shareholdings amount to at least 25 per cent.

³Unless the German company owns 25 per cent or more of the voting stock of the Israeli company. In the latter case, the dividends are exempt at the shareholder's residence (Method 4).

Method 4: Exemption of dividend at investor's domicile and full taxation in host country

The treaties of India with Austria (1963), Denmark (1959), Finland (1961), Norway (1959) and Sweden (1958) provide for full taxation of inter-company dividends in the source country and their exemption in the investor's home country. The same rule applies under the treaty between Argentina and Sweden (1962).

A number of other treaties include this rule in modified form. The treaties of the Federal Republic of Germany with India (1959) and Israel (1962) apply if inter-company shareholdings amount to at least 25 per cent in terms of voting power. Sweden grants the exemption under its treaty with Brazil (1965) according to the rules applying to domestic inter-company dividends. Exemption of the dividend at the investor's domicile and full taxation in the host country is also the rule under the treaties of Thailand with Denmark (1965), Norway (1964) and Sweden (1961), unless inter-company shareholdings amount to more than 25 per cent. In the latter case, the withholding tax in the source country is reduced (Method 5).

Method 5: Exemption of dividend at domicile and reduced taxation in host country

This method is applied under the treaty between Ceylon and Norway (1964) and the treaties of Pakistan with Sweden (1958) and Switzerland (1959). Other conventions include this provision if inter-company shareholdings amount to at least 25 per cent or, in some cases, more than 25 per cent. This is the rule under the treaties of the Federal Republic of Germany with Ceylon (1962) and Pakistan (1962), the treaties of Thailand with Denmark (1965), Norway (1964) and Sweden (1961) and the treaty between the Philippines and Sweden (1966).

Method 6: Exemption of inter-company dividends both in source country and at the shareholder's domicile (under rules applying to domestic inter-company dividends)

This rule only appears in the treaties of Sweden with Morocco (1961) and Tunisia (1961).

The following tabulation shows the number of treaties applying the exemption method, the tax-sparing credit and the regular foreign tax credit, classified according to whether inter-company shareholdings amount to more or less than 25 per cent.

	Inter-company Shareholdings	
	At least 25%	Less than
	or more than 25%	25%
Number of tax treaties applying:		
Exemption.....	22	19
Tax-sparing credit.....	9	10
Regular foreign tax credit.....	7	9
	<u>38</u>	<u>38</u>

In summary, more than one-half of the treaties examined exempt inter-company dividends from direct investment in developing countries from the tax of the developed country. The other treaties are about evenly divided between applying the regular foreign tax credit and the tax-sparing credit.

Appendix G

DIFFICULTIES WITH THE INTEGRATION PROPOSAL*

The Government proposes in the White Paper to distinguish between two categories of Canadian corporations for income tax purposes—"widely held" and "closely held." Coincidental with the introduction of this concept of two tax-paying entities into our tax system would be the adoption of a complex gross-up and credit, or integration, approach to the taxation of corporate and inter-corporate dividends. The purpose of this Appendix is to consider the probable effects of the integration proposal on Canadian business and economic affairs.

Integration as proposed in the White Paper would replace the present dividend tax credit now received by individual Canadian shareholders. Inter-corporate dividends passing tax free under existing income tax legislation would also be dealt with on a gross-up and credit basis. The Government asserts that its proposal for integration would promote a more significant degree of equity among different classes of shareholders and correct an alleged problem under the present dividend tax credit system whereby, in certain circumstances, resident shareholders are offered credit for corporate tax that has not, in fact, been paid.

Integration between the corporation and its Canadian shareholders would be complete in the case of the proposed closely held Canadian corporation. Such a company would be subject to regular corporate rates of tax, with full credit for such tax passed on to Canadian shareholders through the declaration and payment of either cash or stock dividends. Alternatively, the White Paper provides that the shareholders of a closely held company could, in certain limited cases, elect to be taxed as a partnership. In this event there would be no corporate tax, and the profits of the company would be taxed as if they had been received by the shareholders annually.

It is proposed that the Canadian shareholders of widely held Canadian corporations would receive credit for 50 per cent of the applicable Canadian corporate tax paid on the earnings distributed. Shareholders would accordingly report dividends in their individual income tax returns on a "grossed-up" basis representing cash dividends actually received plus 50 per cent of the corporate tax applicable

*This memorandum was prepared by the staff of The International Nickel Company of Canada, Limited in collaboration with its legal and accounting advisors.

to the income out of which dividends are paid. Taxes would be calculated by the shareholders on this amount, and the applicable corporate tax would then be applied as a credit against the resulting tax liability. The foregoing remarks assume that the dividend is fully covered by creditable corporate tax.

Under the White Paper's proposals, all corporations would be required to maintain memorandum creditable tax accounts. One-half of corporation taxes paid by widely held Canadian corporations and all the corporation taxes paid by Canadian closely held corporations would be credited to such accounts. Taxes which are paid as a result of rates exceeding 50 per cent, would not generate creditable tax.

Stock dividends would be treated in a manner similar to cash dividends in the case of both closely held and widely held Canadian corporations and would be included in a shareholder's income on a grossed up basis subject to a credit for corporate tax paid. The Government has also proposed that the integration system would be operative only where distributions are made within a two-and-one-half year period following the earning of the applicable taxable income. This rule would apparently apply to both closely held and widely held corporations and to both cash and stock dividends.

It is interesting to note that the Government apparently rejected the concept of complete integration in the case of widely held Canadian corporations because it considered that such Canadian companies compete with public corporations in other countries, and "it is natural for the competition to bear a corporation income tax." Further, the Government considered it "likely" that some part of the corporate tax is passed on to customers.¹ Even though the Government seemed uncertain as to the actual incidence of corporation tax—who actually bears the burden of such tax—it nevertheless proposed the integration system outlined above. It is difficult to find any convincing support in the White Paper as to why precisely one-half of the tax on public companies and all of the tax of other companies should be considered as being borne by shareholders and hence eligible for credit against the shareholders' tax liabilities.

Investment Decisions

The introduction of integration into our Canadian tax system would import a new element into Canadian investment decisions. The Government has pointed out, in a technical paper released on March 19, 1970 by Finance Minister E. J. Benson describing the mechanics of the proposed integration system, that creditable tax will accumulate on a "tax payment" basis. In other words, accumulation of creditable tax will commence with the initial corporate tax instalment payment following implementation of the new system.

In the case of many corporations, prospective shareholders and their investment advisors cannot possibly know the amount of the corporation's creditable tax that would be available for allocation during any year. Accordingly, they will not be in a position to evalu-

¹*Proposals for Tax Reform*, paragraph 4.34.

ate the net after-tax return that might be anticipated from dividends received on shares of alternative Canadian companies. Inco believes that this would result in serious problems for the investor and his advisors, and decisions would have to be made in the absence of complete information.

The importance to an investment decision of the availability of creditable tax would further tend to make shares of stable, taxable Canadian companies with established dividend records more attractive to both individual and corporate Canadian investors than the shares of companies that have fluctuating earning records or that are entering upon growth phases.

The problems of various companies relating to creditable tax would be accentuated by the requirement to allocate such tax to shareholders within two and one-half years. Such companies may have no funds available for dividend payments. Stock dividends, which have been suggested by the Government as a solution to this problem, would provide a solution for certain shareholders but may be unattractive to others. For example, a shareholder in a high income tax bracket would prefer to receive profits as capital gains rather than as stock dividends. Some corporations would find themselves in the anomalous position of being unable to act in the best interests of all of their shareholders.

The integration proposal could also operate to discourage Canadian investment in resource companies, growth companies, and companies with significant international operations. Shareholders of such Canadian corporations would likely not be able to obtain full gross-up and credit with respect to dividends received by them. The shares of such companies would represent a less attractive investment vehicle for Canadians than shares of Canadian corporations with stable, principally domestic operations. With this bias reflected in Canadian share prices, non-resident investors would tend to purchase the relatively cheaper shares of resource, growth and international companies. It is questionable whether Canada should implement a proposal that discourages Canadians from investing in the shares of such companies.

The proposed system provides substantial incentives to resident Canadian shareholders through integration credits that are not available to shareholders of Canadian companies who live outside of Canada. In this sense, the White Paper's proposals discriminate against non-resident investors. This may have adverse effects on Canadian economic development in a number of ways.

First of all, it is reasonable to expect that other countries would attempt to eliminate or modify such discrimination by requesting Canada to provide some of the benefits of the integration tax credit proposals to non-resident investors. Under the recent tax agreement between France and the United States, France agreed to extend some of the benefits of its partial integration system to U.S. portfolio investors by refunding tax credits directly to such investors. In view of the large amount of foreign investment in the Canadian economy, any extension of the integration benefits to non-residents would be

enormously costly in revenue terms.

Second, Canadian integration proposals combined with other aspects of the proposed new tax system would create artificial barriers to the free flow of capital in and out of Canada, both by discriminating against Canadians who wish to invest in foreign companies and by inhibiting certain non-resident investment in Canada. One has only to ask what the reaction of the Canadian Government would be if other countries, such as the United States, adopted the proposed integration scheme to realize that Canada's long-run interests may not lie in creating such artificial barriers to the free movement of capital.

Inter-company Dividends

Inco has examined with some concern the integration proposal as it affects inter-corporate holdings and inter-corporate dividend flows. In Inco's opinion, adoption of the integration proposal would initiate serious inequities and would result in both unfavorable tax consequences and significant complexities.

The Government has proposed that to the extent that an inter-company dividend paid by a closely held company, or by one widely held company to another, is fully covered by creditable tax, such a dividend would not be subject to additional tax in the recipient's hands. The tax consequences would be considerably different, however, where a dividend from a widely held company is paid to a closely held company. In this case, the dividend would be received subject to a minimum tax of 25 per cent, such tax increasing to as much as 50 per cent where the dividend is not fully covered by creditable tax.

This additional tax on inter-corporate dividends paid by widely held companies to closely held companies arises because of the White Paper's proposal that the income of a closely held company should be completely "tax-paid" in terms of the new system, so that no additional tax would be levied on such income when distributed to individual shareholders. Because of the fact that dividends from widely held Canadian companies would be subject to some additional tax in the hands of high bracket shareholders, the White Paper proposes an additional tax on such dividends (of a minimum of 25 per cent) when paid to closely held corporations. This proposal completely neglects the realities of most inter-corporate shareholdings and would create innumerable problems with respect to inter-company dividend flows.

There are many corporate groups in Canada today in which closely held corporations that are themselves owned by widely held corporations own shares in other widely held companies. The White Paper's proposals would place a "penalty tax" of a minimum of 25 per cent on dividends flowing through such a corporate arrangement. (This arises because dividends paid by a widely held company to a closely held company will be subject to a minimum 25 per cent tax, increasing up to 50 per cent where the dividends in question are not fully covered by creditable tax. This means an overall effective corporation

tax rate of between 62½ per cent and 75 per cent.) Many important Canadian corporate groups would be crippled by these proposals which would subject them to enormous tax penalties for no obvious reason. While some corporate groups could re-arrange their affairs to avoid part or all of this additional tax, others could not because of various legal, financial and commercial restrictions. Accordingly, the tax would impose a capricious burden on Canadian corporations.

Many non-resident investors have set up Canadian holding companies which would be "closely held" under the White Paper proposals to hold shares in other Canadian companies. These companies would also find themselves subject to sharp and unexplained tax increases because of the inter-company dividend proposals, which in many cases would subject their Canadian investment earnings to a minimum additional tax of 25 per cent. Further substantial problems would arise where foreign income flows through Canada to foreign shareholders of Canadian companies. The net result would be to drive such companies outside of Canada with a consequent loss to the Canadian economy of the funds that would otherwise be invested here, and a loss in Canada's reputation for treating non-resident investors fairly.

Companies falling within the "widely held" designation would accordingly be reluctant to declare and pay dividends where a substantial number of their shareholders were "closely held" companies. Accordingly, funds could be "locked in" a subsidiary company even though the optimum business decision might demand a transfer of such funds to another corporate entity.

It becomes obvious that companies would be seriously limited in their ability to move funds within a corporate group because of the necessity to cover inter-corporate dividends with adequate creditable tax. A parent corporation would not wish to create a tax liability by having a subsidiary pay dividends out of profits that are not covered by creditable tax.

It is not unrealistic to envisage situations wherein controlled subsidiary corporations might have ample funds to declare and pay dividends; however, through the claiming of excess capital cost allowances or other incentives, the subsidiary might lack the necessary creditable tax required to cover such dividends. In such circumstances the inter-corporate management of funds would be seriously restricted and the corporate group as a whole might be prevented from formulating effective business decisions and from operating in the most expedient commercial manner.

Some corporate groups would doubtless be able to minimize the inter-corporate problem by having subsidiaries elect to be treated as partnerships with the parent taking up its share of the subsidiaries' income for tax purposes and receiving distributions tax free. This partnership option would not provide a complete solution to the problem, however, since many companies might not be able to make such an election because of proposed qualification requirements for the partnership election such as restrictions on capital structure and the necessity that all shareholders be resident in Canada.

Dividend Policies

The White Paper's integration proposal would force corporations to formulate their dividend policies at least in part by reference to the amount of creditable tax available at any particular point in time. Canadian investors would be discouraged from investing in corporations that cannot offer shareholders sufficient creditable tax to cover dividend payments. Where creditable tax is not available to cover dividends distributed, Canadian shareholders would have a significantly higher tax burden than they would have on dividends received from corporations offering full creditable tax.

Many corporations would be unable to offer their shareholders sufficient creditable tax to support a long-run consistent dividend policy. For example, where a company has constructed facilities in an area designated under the former Area Development Incentives Act, accelerated capital cost allowances are available in respect of its fixed assets falling within Classes 20 and 21 of the Regulations to the Income Tax Act. In his budget address of March 12, 1970, Finance Minister Benson indicated the Government intends to extend the accelerated capital cost allowance now applicable to water pollution control equipment to air pollution control equipment. Under the White Paper proposals, accelerated capital cost allowance would also be available with regard to various assets acquired in connection with a new mining operation. While a corporation availing itself of such accelerated capital cost allowances would reduce its overall corporate tax liability, the tax saving enjoyed by the corporation could be offset by the additional tax collected from the shareholders on dividend distributions.

Incentives are also offered by the Government in the form of tax-free grants under the Industrial Research and Development Incentives Act to encourage scientific research and development in Canada. Reference might also be made to the earned depletion proposal in the White Paper, a proposal introduced with the stated intent of encouraging exploration and development in Canada.

Similar difficulties would arise with respect to any special incentives which may be offered to small business.

By taxing distributions out of untaxed revenues from incentives such as the foregoing, the Government would be offsetting to some extent the incentives it has itself formulated and approved. Through the taxation of dividends in this manner, or through forcing retention of the relevant funds because of the unfavorable tax consequences of distributions therefrom to shareholders, the Government is placing itself in the anomalous position of undermining its own incentives. Taxing incentives at the shareholder level that were previously granted at the corporate level would weaken the Government's ability to influence corporate decisions and would ultimately result in a decreased use of tax incentives (such as the accelerated write-offs on pollution control equipment) for social policies.

Following the period of transition to a maximum 50 per cent personal tax rate, companies with sufficient creditable tax might

experience some shareholder pressure to pay out somewhat higher dividends than they would normally wish to pay, especially where the expiry of creditable tax is threatened. Indeed, it is most probable that once the maximum personal tax rate has fallen to 50 per cent, closely held companies would pay out their total earnings in dividends so that shareholders receive credit for corporate tax paid. While some portion of such dividends would be reinvested in shareholders' loans, the balance would be spent on consumption.

To the extent that integration results in increased dividend payouts by Canadian companies, it would not be unrealistic to anticipate the following trends:

- a. A decrease in savings by corporations.
- b. An increase in expenditures by individual shareholders by virtue of increased dividend payouts, with a corresponding increase in inflationary pressures.
- c. Additional borrowings by corporations to finance increased dividends and growth, thus increasing pressures on the money market and resulting in higher interest rates.

Indeed, the White Paper's proposals would create a whole new range of difficulties for Canadian public companies and their relations with shareholders at the same time as the Government is trying to encourage Canadians to invest in such companies.

The tax payments of many Canadian companies vary enormously from year to year, since such items as accelerated capital cost allowance and irregular capital spending, incentive and disincentive capital cost allowance provisions, and changes in business conditions influence taxable income. Because of the influence of such items as special capital cost allowance provisions, variations in taxable incomes and tax payments are likely to be far larger than variations in accounting earnings reported to shareholders. A large number of companies would find that over a period of ten years or so they would have sufficient creditable tax in the aggregate to cover all of their dividend payments. Many of the same companies would find, however, that in some particular years, they would have insufficient creditable tax for this purpose because of fluctuations in tax payments and the two-and-one-half year expiry rule for creditable tax. Public companies traditionally wish to maintain stable dividend policies to encourage investor confidence and provide a continued source of income to shareholders. Many Canadian public companies would find, however, that under the White Paper's proposals they would be required to adopt one of the following alternatives:

- a. Vary their dividend policy from year to year and quarter to quarter, to take account of variations in creditable tax available.
- b. Maintain a consistent dividend policy but allow some dividends to be paid without creditable tax, while on other occasions allowing creditable tax to expire.
- c. Artificially increase their tax payments and tax liabilities in some years—perhaps through claiming less than maximum incentive allowances—to permit shareholders to always obtain the

full benefits of integration.

The unattractiveness of all of these alternatives must serve as a comment on the validity of the entire integration proposal.

Record Keeping and Administrative Complexities

Record-keeping complications would arise under the proposed system, particularly where a separate pool of foreign creditable tax is involved or in the case of income flowing through a series of companies to individual shareholders. To record creditable tax properly, new accounting records would have to be maintained, resulting in additional unproductive costs to Canadian corporations.

Under the White Paper's proposals, corporations would have to issue a dividend information slip (a greatly expanded version of the present T-5 form) with each dividend check sent to shareholders. This expanded T-5 form would have to show not only the names and addresses of the payor and payee, the date, and the amount of the dividend, but also the amount of creditable tax and foreign creditable tax applicable to that dividend, and the total "grossed-up" amount that the shareholder would be required to include in his income. Because of the requirement to issue such slips at every dividend payment date, instead of annually as at present, many corporations would be forced to issue two to four times the number of information returns that they now do, with consequent increases in their book-keeping costs, their shareholders' ability to maintain and understand their records on dividend receipts, and the difficulties that the Government would have in matching its copies of such slips with shareholders' tax returns.

A number of practical difficulties would arise under the proposed integration system in the case of adjustments to corporate taxable income resulting from reassessments and loss carry-backs. Where a company has passed on to its shareholders all the creditable tax applicable to a particular year, the company would evidently be precluded from carrying back a loss incurred in the following taxation year and obtaining a refund of corporate tax paid. Reassessments are likely to present even greater problems because lengthy litigation is often involved. For example, a decision by the Exchequer Court concerning costs incurred in 1958 by Inco in constructing a townsite at the location of a new mine was not reached until 1969. In situations such as this, it has been indicated that if a company's liability for the amount of tax in dispute is eventually confirmed, a further period would be allowed in which to pass on the relevant creditable tax to shareholders. This procedure could in itself result in an increase in disputes as it provides companies with an opportunity to extend the normal two-and-one-half-year period for expiry of creditable tax. Even more difficult problems would arise where substantial refunds of tax are received in one year as a result of a corporate taxpayer's winning a tax dispute.

In view of the above, Inco believes that the Government would experience significant administrative problems in auditing the creditable tax records of corporations. As Inco has noted elsewhere

in this Appendix, many situations would arise where dividends might be paid out of earnings or gains which had not, in fact, been subject to tax. Such distributions would therefore not carry any creditable tax. Similarly, there would be situations where, while creditable tax is distributed by a corporation with a dividend payment, such tax might be inadequate to cover the entire dividends distributed, especially where there are different classes of shares outstanding. Inco believes that the reporting requirements that corporations would have to fulfill in respect of dividend payments would lead to some confusion on the part of shareholders and, as a result, the Government's administrative problems would be increased.

Inco has studied the Government's integration proposal in some detail, endeavoring to direct its study not only to the effects such a proposal might have upon Inco and the mining industry, but also to Canadian business generally. The Company has concluded that, while recognizing certain advantages inherent in an integration concept such as that proposed, the practical difficulties and problems initiated through the adoption of integration combine to outweigh the conceivable benefits.

APPENDIX "C"

**BRIEF
ON**

**THE WHITE PAPER
PROPOSALS
FOR TAX REFORM**

of Honourable E. J. Benson
MINISTER OF FINANCE

SUBMITTED

— to the House of Commons Standing Committee on Finance, Trade
and economic Affairs

— to the Standing Senate Committee on Banking, Trade and Commerce

BY

The Province of Quebec Chamber of Commerce

MAY 1970

Preamble:

The Government of Canada has submitted before the Canadian people its major proposals for the reform of the income tax structure.

The Province of Quebec Chamber of Commerce has studied the document presented by the Minister of Finance, Mr. Benson, and submits its observations to the government.

Our movement is a federation of 261 Local Chambers of Commerce and Boards of Trade active in the Province of Quebec. We comprise more than 33,000 individuals and some 1,850 corporate members (industrial, commercial and professional corporations) working to promote and maintain the economic, civic and social well-being of the Province of Quebec.

We have asked our local Chambres of Commerce to study the White Paper on tax reform and to make their comments known to us. In addition, the Board of Directors, which is composed of representatives of all regions of Quebec, met in a special assembly on March 19, 1970, for the purpose of preparing this brief. The brief was then their approval. We are, consequently, expressing the views of all Chambres of Commerce in the Province of Quebec.

The Canadian people has waited eight years for the Government to announce definitively what the fiscal reforms would be. It seems that many business interests have delayed investing in Canada as soon as the Carter and Benson reports were presented not knowing definitely what would be changed in our system of taxation.

It is customary for investments to be planned several years ahead and the uncertainty has surely been a hindrance to us in this field. It is urgent for the Government to stabilize our tax regulations.

The Province of Quebec Chamber of Commerce congratulates the Government of Canada for making it possible for the Canadian people to be informed of and to discuss the proposals for tax reform before adopting specific legislation.

Major observations on the report.

We have studied the different goals and standards which have guided the government in the preparation of this report.

Each goal has an indisputable value. Let us take, for example, the first three, that is:

- a) "a fair distribution of the tax burden based upon the ability to pay";
- b) "steady economic growth and continuing prosperity";
- c) "the recognition of modern social needs".

Evidently, each objective possesses an intrinsic and real value, but the government should attempt to balance their application.

It would be unrealistic to pretend to be able to provide all the services that the public is asking for without taking into account the economic repercussion which would follow the implementation of these programs on a national scale. It is, therefore, necessary to maintain the prosperity of the country while at the same time providing social services to the public. In the same way, it is necessary to spread the fiscal burden so that it will not slow economic growth and continuing prosperity.

All of these goals should be carefully analysed, taking into account practical limits and the possible effects of their application on the whole Canadian economy.

The Canadian Government is proposing wide fiscal reforms in which almost all tax regulations will be modified or changed.

It seems to us that it is wrong to use this fiscal re-arrangement to increase the burden on the Canadian taxpayer.

According to the report, it is indicated that the revenue of the federal government will increase

by \$600 millions in the course of the next five years. We are unable to verify the correctness of this figure, although the Government of Ontario has otherwise estimated that it would be doubled.

We believe that the government should attempt to arrive at an estimate in a less questionable and arrive at a more acceptable figure in respect to the amount of additional revenue that it will draw from this proposed system.

Low-income taxpayers will benefit from a decrease in their fiscal burden. We support the proposal of the White Paper which would decrease the fiscal burden on low-income taxpayers.

On the other hand, taxpayers having an average income of more than \$8,000 will be penalized since they will have to make up for the loss of revenue to the treasury from this source, that is, \$1.2 billions, as well as pay the increase provided for, being a minimum investment of 600 millions dollars and probably one billion dollars and more.

This category of taxpayers contributes more to the prosperity of the country by its savings and by its dynamism. It seems to us that this group will be heavily affected by an increased tax burden and we believe that one of the consequences could be the slowing

down of the economic expansion of Canada.

The government should therefore take into consideration that 70% and more of new personal taxes will be collected from 1,121,000 Canadians who earn between \$8,000 and \$15,000.

We do not believe that this class of citizens who have savings and invest them in our economy should be required to assume so large a part of the increase in taxes. We ask ourselves if the government has correctly evaluated the consequences of these changes in relation to the goal of steady economic growth and continuing prosperity.

The White Paper was prepared taking into account one of the goals or standards which is described as follows: "understanding of and voluntary compliance with tax laws, combined with enough details to block loopholes". (White Paper, no. 1.6)

In reading the document we are frequently reminded of the government's objective. The report on tax reforms enumerates the effects of the changes which will be introduced and especially those which will prevent all forms of tax evasion.

We believe that the goal of eliminating tax evasion is desirable and justified, but it seems to us that the specialists of the Department of Revenue could

have eliminated the majority of the loopholes by a more severe application of the existing regulations. It does not seem necessary to introduce so drastic a tax reform to attain the desired result.

Position of the Province of Quebec Chamber of Commerce
on some of the recommendations of the report.

1. Taxes on small businesses.

The report recommends the withdrawal of the preferred low tax rate on the first \$35,000. of profits and the establishment of an uniform rate of 50%, the assimilation of dividends into the income of shareholders, and the granting of tax credits equal to the amount or half the amount paid by the businesses. It seems, according to the statistics for 1967, that 18% of the revenue from corporate taxes derives from 88% of Canadian companies with income lower than \$35,000.

The government wishes to place all Canadian businesses on the same level. We do not believe that this recommendation would favour expansion of businesses belonging for the most part to Canadians. Small and medium-sized businesses will have great difficulties in accumulating the funds necessary for their normal expansion; consequently this situation will offert the economic growth of our country.

The government should find a formula which would permit small and meidium-sized businesses to use a part of their profits for expansion, because sources of capital supply are limited and difficult of access for these businesses. We believe that the shareholders of these

companies should be encouraged to use a larger part of their profits for expansion rather than accept the payment of dividends as favoured by the new formula. This preferential rate should continue to be applied especially in the case of business which generate jobs. However, this measure should not favour individuals who form investment companies with the aim of taking advantage of this low rate to avoid taxation.

It seems to us therefore that the government should maintain this advantage of a preferred rate on the first \$35,000. of profit, even if the new formula of tax credits partially compensate for its withdrawal.

2. Capital gains tax.

The report recommends the integration of capital gains into the income of taxpayer. The Province of Quebec Chamber of Commerce recorded its opposition to this tax at its Annual Meeting of 1969.

We believe that the capital gains tax would be harmful to the economic development of Quebec. Our province needs considerable capital to maintain its prosperity and to develop the many sectors of our economy. The greater part of the capital invested in Quebec derives from outside investors. We believe that the capital gains tax would slow down investments in Quebec and especially in the

in the developpment of our natural resources.

3. Evaluation of estates.

The Minister of Finance has announced that the capital gains of a corporation which is majority-owned by Canadians will be subject to taxation on the death of a shareholder, if they have not been taxed every five years.

In addition to its opposition to the imposition of a capital gains tax, the Chamber wishes to emphasize that estate taxes constitute, a field of taxation which should be exclusively reserved to the provinces and from which the federal government should withdraw. The federal government should provide for reforms in the Canadian tax system to make a change in the field of estate taxes.

4. Residence.

The Chamber is opposed to any taxation of capital gains resulting form the sale of the principal residence. We believe that this proposal would involve a system that would be complicated for the taxpayer and the small revenue which the government would collect would not counterbalance the resulting inconveniences.

5. The Mining and petroleum industries.

The report proposes changes in the dispositions of the tax laws governing the mining and petroleum industries. The Chamber is of the opinion that the government should maintain the three years tax exemption granted to mines as well as the depletion allowances given to operators and non-operators against their taxable mining income.

We believe that the government should encourage this type of investment through appropriate fiscal stimulants, if it wishes to maintain the rhythm of our economic growth.

6. Personal income tax reforms.

The increase in the exemption from \$1,000. to \$1,400. for an unmarried person and from \$2,000. to \$2,800. for a married person is acceptable to the Chamber. We also appreciate the provision for child-care expenses.

The Chamber believes that these proposals are realistic in lessening the tax burden on persons with low incomes and in permitting the deduction of essential expenses for a woman who works outside the home.

7. Employment expenses.

The report recommends the granting of a deduction of 3% of gross income or a maximum of \$150.

The Chamber is of the opinion that it is just and appropriate to grant tax deductions to all employees for expenses inherent in the performance of their work.

8. Representation and connected expenses.

The government wishes to exercise stricter control over the expenses of certain taxpayers or corporations. The costs of employees participation in or travelling to conventions, dues in social or recreational clubs, the operation of luxury yachts, the costs of attending conventions held outside the country in tourist areas, expensive entertainment, the costs of hunting lodges and similar expenses will not be deductible.

It seems to us that the Department of Revenue should have been able to control these deductions by a tightening of its regulations. In this way, it would have been possible to control more strictly the costs of representation and related costs without suppressing the right of deducting expenses which were justified and legitimate.

We believe that, in principle, expenses incurred to create income should be accepted as deductible by the government.

9. Investment income of clubs and other non-profit bodies.

The report recommends the taxation of the income on the investments of certain non-profit organizations presently exempted from taxation. The Province of Quebec Chamber of Commerce does not believe that it should be grouped with non-profit organizations, as defined in the report, since it falls under a special act of the Canadian Parliament. Furthermore, we suggest the establishment of a level below which it would not be necessary to make an annual return. We believe that this measure will aid in the implementation of this law.

10. Public utilities.

The federal government pays to the provinces 95% of the tax revenue received from public utility corporations. By this fact, the central government can not grant to taxpayers who hold shares in these enterprises the tax credits which it grants to the shareholders of all other Canadian corporations.

We do not believe that an agreement between the federal government and the provincial governments should affect taxpayers by depriving them of tax cre-

dits which are granted to other taxpayers holding shares of other corporations.

It seems that it is necessary for the federal government to consult the provincial governments for the purpose of finding a solution to the problem of granting tax credits.

11. Amortization.

The report recommends that an inherited property remain at the point of amortization at which the testator left it at the time of his demise. Moreover, no taxpayer would have the right to deduct from his other income the loss resulting from the ownership of a property, when this loss would be imputable of the allocation of capital costs. Also, any rented property valued of \$50,000. or more would be placed in a separate category.

We believe that it is equitable to place the inherited property at the level of amortization at which the testator left it. Moreover, certain taxpayers would not be able to perpetrate tax evasions by deducting from their income losses due to the allocation of capital costs.

Finally, the Chamber is of the opinion that to place any rental property with a value of more than \$50,000. in a special category would reduce the number of investors in this sector, where the need is very large.

12. Liberal professions.

The report recommends that the liberal professions be required to establish an accounting system based on the accrual rather than the cash system.

It seems that such a change would seriously affect those who wish to begin the practice of their profession. The Chamber believes that it would be extremely difficult for certain professional people to pay annually their indicated tax when their accounts receivable may extend to one or two years.

We believe that the government should maintain cash accounting or another system, instead of the proposed formula that would affect the practice of certain professions.

13. General Income-Averaging Option

The general income-averaging option, which has been allowed up to now to fishermen and farmers, to writers and to certain categories of businessmen, will be allowed to all taxpayers.

It seems that the beneficial effects of the recommendation will be lessened by its application to the higher revenues by the amount of 133% of the average revenue of previous years. We believe that the American

formula which permits an income averaging option of the income higher than 120% would be preferable and more equitable.

14. Fiscal integration.

The integration of the tax on the income of corporations and individuals is desirable for the improvement of our tax system. In effect, integration will eliminate the system of double taxation of the income of corporations and shareholders.

The proposed system defines two types of corporations. It introduces complete integration and its implementation represents a major evolution of our tax system, even if the proposed formula is more complicated than we would have wished.

We believe that if the Department intends to hold to the same long-term goals, it should set up a transitional plan spread over many years; this could be done by the issuing of credits on dividends. On the other hand, the Department could accept a simplified formula, which would consider dividends as interest for tax purposes. Thus integration would be complete in respect to the proportion of income distributed to shareholders.

15. Taxing international income.a) Income of Canadians received from outside the country.

The White Paper proposes the adoption of regulations based totally on those which are in force in the United States. This proposal will require the drawing up of difficult and complicated legislation, but the problem is a major one and does not lend itself to any easy solution.

We believe that it will take several years before the government is able to enter into signed bi-partite treaties with, among others, the United States. It should be drawn to the attention of the Government of Canada that it would be harmful to tax Canadian companies on the same bases that the American government exercises its own prerogative in respect to its own country. It should also be considered that many Canadian companies are not as productive as similar companies in the United States. It would be harmful to our own development, in respect to the creation of wealth and employment, to tax our own industries too heavily, in relation to similar and competitive American industries.

b) Canadian taxation of non-residents.

The Benson Report proposes to bring the statutory rate of the withholding tax on foreign investment in Canada to 25%. The present rate is fixed at 15%.

The Chamber wonders whether the substantial increase, suggested by the report, to become effective on January 1, 1974, would slow down foreign investment in Canada, since we have the strong impression that other countries of South America, would be more interesting to American, German, Japanese or other capital. It is possible that the industrial development of Canada would slacken because of a lack of outside capital. We are in agreement with the report when it states that Canada has an enormous need of more capital than that available from the total of annual savings.

Conclusions.

The Province of Quebec Chamber of Commerce believes that the White Paper on Tax Reform contains very sound recommendations for the improvement of our income tax system. On the other hand, we have, in this submission, stressed our opposition to certain recommendations.

The Chamber has made comments on several recommendations, advancing its views, and has raised many questions which require answers.

At the present time, it seems that the government cannot foresee in a sufficiently precise manner the direct effects which would follow the application of these recommendations. We would have appreciated a more profound study, which would have enumerated the advantages or disadvantages of each recommendation.

We suggest that the government should offer sound alternatives to the disputed proposals. To a very large extent, the individuals and bodies which have submitted briefs do not have the resources and the information necessary to propose different solutions.

The Chamber is of the opinion that the proposed system seems more complex and difficult to apply to Canadian taxpayers. We would have appreciated

proposals for tax reform which were simple and easily understandable by all taxpayers.

We wish again to thank the Government of Canada for having presented a White Paper on Tax Reform. It gives an opportunity for all taxpayers to make their views known on the different recommendations proposed by the government.

We hope that the Government of Canada will quickly reach a final decision, so as to provide Canada with a stable and durable system of taxation.

Standing Senate Committee

APPENDIX "D"

SUBMISSION

TO

THE SENATE COMMITTEE

ON BANKING,

TRADE, AND COMMERCE

by

THE CHEMICAL INSTITUTE OF CANADA

151 Slater Street

Ottawa 4, Ontario.

May 1, 1970

SUBMISSION

BY

THE CHEMICAL INSTITUTE OF CANADA

THE GOVERNMENT WHITE PAPER ON TAXATION

1. SUMMARY

1.1 The Chemical Institute of Canada (C.I.C.) is the 10,000 strong association of chemists and chemical engineers across Canada. It functions as the national chemical focus in Canada in the international world of chemistry and chemical engineering.

1.2 The C.I.C. finds itself adversely affected by some of the White Paper proposals and suggests ways of overcoming this.

1.3 The C.I.C. notes that the White Paper proposals appear to bear unfavourably on the long and financially sensitive process of scientific discovery and utilization.

1.4 The C.I.C. believes that the Government's proposed tax policy and its science policy should not be developed independently, but should reinforce each other.

1.5 The C.I.C. further believes that science and technology can be harnessed to provide economic growth, environmental control and social equity, and that these broader goals should form the basis of Government tax policy.

2. RECOMMENDATIONS

2.1 The C.I.C. claims exemption from the changes proposed in the White Paper to Section 62 (1)(i) of the Income Tax Act.

2.2 The C.I.C. claims that attendance at the conferences it organizes to convey chemical and chemical engineering knowledge and know-how constitutes legitimate, deductible business expenses. Proof of this may be obtained by the Minister from Government authorities administering public funds in support of chemistry and chemical engineering.

2.3 The C.I.C. emphasizes the importance to Canada of encouraging scientific discovery and its utilization. It recommends that taxes should therefore be paid on the results of, not on the process of, scientific and technological creativity.

2.4 The C.I.C. recommends that the Government should not rely solely on tax policy to obtain social fairness, but should also explore ways of utilizing science and technology to achieve economic growth, environmental control, and social equity.

3. THE CHEMICAL INSTITUTE OF CANADA

3.1 The Chemical Institute of Canada (C.I.C.) is a national, non-profit, association of some 10,000 chemists and chemical engineers, drawn from consulting, government, industry and universities.

3.2 The first organization for chemists in Canada was founded in 1902 as a branch of the Society of Chemical Industry. The Canadian Chemical Association received its charter in 1922, and this charter was amended to become the charter of The Chemical Institute of Canada in 1945.

3.3 During this period of 68 years, chemists and chemical engineers have developed an organization which functions across Canada. It acts through forty local sections; through eleven subject divisions; through one constituent society; through a series of regularly organized national and international conferences on all topics which concern its members, whether specialized, general or cross-disciplinary; and through the publication of four scientific periodicals. It cooperates with the National Research Council in international chemical events in which Canada participates.

3.4 The C.I.C. has recently taken part in the development of a national science policy for Canada: by preparing a report on chemistry and chemical engineering for the Science Secretariat/Council; by submitting a brief to the Senate Committee on Science Policy; and, as a result of the latter, by playing a leading role in the formation in 1970 of "SCITEC", the first association of Canadian scientific, technological and engineering societies.

3.5 The C.I.C. has become the national chemical focus in Canada in the international world of chemistry and chemical engineering.

4. GOVERNMENT ACTIONS AND THE C.I.C.

4.1 A number of Government actions are affecting the C.I.C.

4.2 In 1968, the Postmaster General made postal charges 700% higher for non-profit societies than for commercial publishing houses. The additional cost to the C.I.C. in 1969 (\$20,000) was equal to 14% of its general revenues.

4.3 In the White Paper the Minister of Finance now proposes to disallow expenses of attending C.I.C. conference and to tax the investment income of some, but not all, organizations, including that of the C.I.C.

4.4 Subsequently, the Minister of Finance has asked for suggestions concerning allowable and non-allowable expenses.

4.5 The White Paper does not define "conventions", but the C.I.C. does not hold "conventions". The C.I.C. organizes working conferences and trade exhibits to communicate the most recent chemical and chemical engineering science and technology, from those who have it to those who need or want it. The C.I.C. suggests that the proper authorities to provide proof of these activities to the Minister are those which currently administer public funds for the support of chemistry and chemical engineering, for example, the National Research Council.

4.6 The C.I.C. has a small trust income of \$8,000 a year. The C.I.C. trusts stipulate that this income is to be used: (i) to grant medals for merit and to stimulate student interest; and (ii) to permit eminent chemists and chemical engineers to visit its geographically-scattered sections, and thus reduce regional disparities and the effects of their isolation from major centres.

4.7 The C.I.C. notes that the Minister does not propose to tax the investment income of organizations such as Chambers of Commerce, labour unions, cooperatives, university foundations, or non-profit research corporations. The C.I.C. therefore claims exemption from Section 62 (1)(i) of the Income Tax Act on the same grounds as these organizations.

4. TAXATION AND TECHNOLOGY

5.1 The second part of this submission deals with taxation in relation to research, development and utilization of chemistry and chemical engineering in Canada.

5.2 In contrast to natural resources, discoveries, inventions and innovations are highly "mobile", that is, they can be developed and commercialized as easily outside Canada as within Canada, and they are financially sensitive.

5.3 The discovery and practical use of chemical science requires commitment of successively greater human and financial resources through the research, development and utilization stages.

Life Cycle in Years

5.4 Money is therefore at risk for a lengthy period during the commercial development of a scientific/technological discovery. The inventor has the highest chance of success if taxes are deferred during the critical initial stages; and the tax collector stands to gain from this deferral through the additional taxes generated during the successful final stages.

5.5 However, the White Paper proposes to increase rather than decrease or defer taxation on scientific and technological developments in Canada:

- (a) by eliminating the lower rate of tax for small businesses (which has assisted inventors considerably);
- (b) by taxing closely-held corporations (including partnerships) as persons;
- (c) by taxing capital gains (whether realized or realizable. The position of inventors is not clear); and

- (d) by a reduction in private and corporate savings (which will reduce the pool of risk capital available in Canada).

5.6 Such policies are likely to have only one effect on a country in Canada's position. When a tax push is combined with a market-pull, some inventors, their inventions, or both will tend to gravitate, one way or another, to other countries which they believe will give them fairer tax treatment and better opportunities for their work.

5.7 The C.I.C. therefore recommends that the Canadian Government use the one weapon wholly within its control, taxation, to promote the development and use of science and technology in Canada, and thus maintain or increase Canada's position in the world in the technological era of the seventies.

6. THE CONTRIBUTION OF CHEMISTRY AND
CHEMICAL ENGINEERING TO CANADA

6.1 The Chamber of Commerce has already stated in its brief to this Committee that the only real basis for social equity is economic growth.

6.2 The Chamber of Commerce also noted that "technological development since the war has proven that economic expansion and rising living standards are achieved through sharply rising investment of capital, with concentration in the most modern, the most technological and capital intensive industries".

6.3 In its recent examination of national science policy in Canada, the Organization for Economic Cooperation and Development (OECD) observed that "Canada has reached a significant international level" in products exported by the research-intensive industries.

6.4 Chemistry and chemical engineering are basic elements in this scientific and technological progress.

6.5 The current momentum is such that science and technology will affect human beings and their societies more during the seventies than during any previous period of history.

6.6 Given these premises, what tax policies should be followed, and what should be done?

6.7 The Canadian Government is currently developing its national science policy. The C.I.C. therefore recommends that the Government should examine its proposed tax and science policies to ensure that they reinforce ("synergize") each other.

6.8 Science and technology not only provide economic growth as stated above, but they also affect our environment and our society. The success of science and technology in generating economic growth is now well known and should therefore continue to be encouraged by Government policies; the need to use science and technology much more positively in the control of our environment is increasingly recognized; but the ability of science and technology to help tackle social problems such as poverty is as yet largely unexplored.

6.9 The C.I.C. therefore recommends that one of the basic political needs of Canada during the seventies is to learn how best to harness science and technology for economic growth and social needs; and that these broader goals, rather than the more restricted aim of tax equity, should guide Canada's tax policies.

ERRATA

TO SUBMISSION TO THE SENATE COMMITTEE ON BANKING, TRADE AND COMMERCE
AND THE HOUSE COMMITTEE ON FINANCE, TRADE AND ECONOMIC AFFAIRS by
THE CHEMICAL INSTITUTE OF CANADA, 151 Slater Street, Ottawa 4, Ontario.

3.2 The Canadian Chemical Association should be replaced by
The Canadian Institute of Chemistry.

4.2 The paragraph should be changed to read:
In 1968, the Postmaster General made postal charges 1300%
higher for non-profit societies; these new rates in turn are
55% higher than the new postal rates for comparable journals
of the commercial publishing houses. The additional cost
to the C.I.C. in 1969 (\$20,000) was equal to 14% of its
general revenues.

June 16, 1970.

APPENDIX "E"

TransCanada PipeLines Limited

SUBMISSION TO THE
STANDING SENATE COMMITTEE
ON
BANKING, TRADE AND COMMERCE
ON
PROPOSALS FOR TAX REFORM
1969

April 14, 1970

SUMMARY

Dividend Tax Credits and Tax on Unrealized Gains

TransCanada PipeLines Limited is very concerned about the adverse effect which the proposed dividend tax credit system and the tax on unrealized gains on public company shares would have on Canadian equity financing of companies which must invest heavily in capital assets in their initial years of operations. The proposed system would also encourage additional foreign investment in equities of Canadian resource and utility industries. This is contrary to the Government policy of Canadian ownership for Canadian industry. We recommend that the present system of dividend tax credits and the exemption for inter-corporate dividends be retained and that the proposal to tax unrealized gains be deleted.

Withholding Tax

In order to provide a stimulus for Canadian ownership of Canadian industry, we recommend that foreign debt capital be encouraged rather than foreign equity capital. The removal of withholding taxes on interest payments on debt capital would facilitate this.

Capital Gains

We recommend re-consideration of the proposal to tax realized capital gains. The rates of tax would be punitive in that they do not recognize that assets appreciate in value over the number of years that they are held and they do not recognize increases in value due to inflation.

Depletion Allowances

We recommend that the present system of depletion for producers and investors in resource ventures be retained. The increased tax burden on production of our resources must be met in higher prices which may affect both domestic and foreign markets. Higher taxes on earnings would also affect the inducement to invest risk capital in resource ventures.

Convention and Entertainment Expenses

We recommend that all expenditures incurred to earn income be allowed as a deduction in computing taxable income and, therefore, recommend deletion of the proposal to disallow entertainment and convention expenses.

Non-allowable Expenditures (Tax Nothings)

The proposal to allow previously non-deductible business expenditures is a much needed change. There should be no question in principle as to the allowance of legitimate business expenditures.

I N D E X

SECTION

- | | |
|---|--|
| A | TransCanada PipeLines Limited |
| B | The Proposed Dividend Tax Credit System |
| C | The Proposal to Tax Unrealized Gains on
Shares of Public Companies |
| D | The Proposal to Increase Withholding Taxes
on Interest Payments on Debt Capital |
| E | The Proposal to Tax Realized Capital Gains |
| F | The Proposal to Revise the Base for
Depletion Allowances |
| G | The Proposal to Disallow Convention and
Entertainment Expenses |
| H | The Proposal to Allow Tax Nothings |

A TransCanada PipeLines Limited

In 1956, TransCanada PipeLines Limited began the construction of a natural gas pipeline system from the Alberta/Saskatchewan border to energy markets in Ontario and Quebec, and to provide for export of natural gas to the United States. This pipeline system, by December 31, 1969, had grown to 3,638 miles representing an expenditure of over \$796 million in pipeline and equipment. Sales of natural gas in 1969 totalled \$231 million, of which \$49 million were export sales to the United States.

The Company also owns 50% of a United States pipeline company which connects with the TransCanada System as a loop line and which has assets of over \$294 million. Additionally, TransCanada, through wholly-owned subsidiaries, is actively engaged in exploration and development of oil and gas reserves in western Canada.

Canadian control of TransCanada is evident by 95.02% of its common stock and 99.75% of its preferred stock being owned by Canadian residents. Canadian ownership has been a result of the willingness of Canadians to invest in companies, such as TransCanada, and of the ability of the Company to attract large sums of foreign debt capital.

This is a brief outline of TransCanada which was formed and is owned by Canadians. It is similar to many other companies which, along with Canada itself, are experiencing a high growth rate which is accruing to the benefit of Canadians.

B The Proposed Dividend Tax Credit System

TransCanada is a company related to the natural resources and public utility industries. Such industries have large investments in capital assets and must attract large sums of both equity and debt capital. These industries, due to heavy claims for depreciation in their initial growth years, defer payment of corporate income taxes during this period.

The normal corporate income taxes weigh heavily on these industries which are required to make large investments in capital assets. When income taxes are added to the normal problems of capital accumulation, they may be critical in the formative years, or in periods of major expansion, unless some relief is offered. The present capital cost allowance provisions provide this much needed tax deferral in these years. However, under the proposed system of allowing credit to shareholders only for corporate taxes paid, the relief available to these companies is partially cancelled in that their shareholders will not be afforded the same treatment as shareholders of companies which are paying full corporate income tax. (Exhibit "1").

The tax reform proposals treat income taxes separate and apart from other forms of government revenue. The total tax burden on corporations is not considered, and as a result there is no relief from double taxation unless only one form of tax, income tax, is actually paid. Companies, such as TransCanada, are taxable but defer payment of income taxes in their beginning period of operations. As a result of TransCanada's large investment in capital assets, the company bears a heavy tax burden to the federal, provincial and municipal governments by way of sales taxes on use and consumption and by way of capital taxes and property assessments. During 1969, TransCanada's total tax burden as a result of the imposition of these taxes was \$8.1 million. This tax compares to the 1969 net earnings of the company amounting to \$14.9 million. Of the \$8.1 million tax burden in 1969, \$4.1 million were sales taxes paid to both federal and provincial governments, incurred as a result of capital asset expenditures and, as a result, a large portion of these taxes are capitalized and not charged to current earnings. As the company's expansion decreases, the incidence of sales taxes would also decrease, but the incidence of income taxes would increase due to a reducing allowance for capital costs. The incidence of sales and income taxes on the company would, therefore, be partially offsetting.

The proposal to extend the tax credit system to dividends flowing between Canadian companies, in the case of those companies which are not paying full income taxes, will result in an extremely high incidence of taxation which would penalize individual shareholders who are finally in receipt of the income. (Exhibit "2").

We are, therefore, greatly concerned about the effect which the proposed tax credit system will have on share values of companies which in their initial years or during periods of major expansion are required to invest heavily in capital assets. As evidenced by Exhibits "1" and "2", the income earnings potential of the investments would be unattractive to both individual and corporate shareholders. This would cause great difficulty in raising capital for resource and utility companies which are vital to the development of our nation.

We are equally concerned that the lower share values of these companies, caused as a result of unfavourable investor reaction to the proposals, would become very attractive to foreign investors. If a United States company purchases shares in these Canadian companies which are deferring payment of income taxes, the after-tax yield would be greater for the United States company. When the company does become subject to full tax on its income, and if the United States company owns greater than 10% of the shares of the Canadian company, the after-tax yield would still be attractive to the United States com-

pany. (Exhibit "3"). In addition, the Canadian Tax Reform provisions will not impose a tax on capital gains on shares of widely-held corporations held by foreign investors if less than 25% of the stock of the Canadian company is owned by the foreign shareholder. (Section 6.47 of the Proposals).

The denial of the dividend tax credit to shareholders of investor-owned electric, gas and steam utilities has received a great deal of publicity from investment analysts, and the proposals are considered to be very harmful to the attractiveness of purchasing equities in these utilities. A similar adverse investor reaction is anticipated for those companies which are deferring the payment of income taxes.

The proposed system will also create many difficulties in administration of the law and accounting for tax credits. The present loss carry-back provisions and four-year re-assessment limit are not compatible with the system. Dividends flowing between companies will require meticulous accounting in order to identify them in dividend distributions. The 2½-year time limit on claiming of taxable credits defeats the reasons for allowing credits for corporate taxes paid and would have an effect on determination of dividend policies of companies. The allocation of creditable tax between various share classes on dividend distributions, should the tax not be sufficient to cover all of the distributions, would present many problems including conflicts of interest of shareholders.

The present system of granting a 20% dividend tax credit does treat people in similar circumstances equally. Shareholders of large public companies consider the company as an entity entirely separate from themselves, and look to their shareholdings as an investment which will provide income and a capital appreciation. The proposed system of taxation will interfere greatly with present and after-tax yields on shares, by providing an additional return, or by substantially decreasing income. One of the objectives of tax reform as stated in Section 1.10 of the Proposals will, therefore, not be met:

"The second main objective of tax reform is to see that the tax system does not interfere seriously with economic growth and productivity. Taxes by their nature cannot always promote all our economic goals, but they should interfere as little as possible with incentives to work and invest and with the directions our economy follows in meeting demands of consumers and foreign markets. Some proposals in this paper are intended to ensure that the incentive to work and invest is not unduly inhibited and that investments needed for productivity and public purposes are not rejected in favour of less desirable alternatives just because of their tax consequences."

Canadian equity investments needed for the resource and utility industries will be affected by the tax consequences presented in the Proposals and investment in these industries may be rejected in favour of other alternatives.

We, therefore, recommend that the present dividend tax credit system, which provides a uniform treatment for all shareholders, be retained.

C The Proposal to Tax Unrealized Gains on Shares of Public Companies

The proposal to tax unrealized gains on the shares of public companies, when combined with the proposed system of partial integration of corporate and personal taxes, would compound the adverse effect on the equity financing of resource and utility companies.

Investors are initially attracted to these companies, which are not paying full income taxes, by their large growth potential. In the developing years the earnings are relatively low, and as a result, dividends paid to the shareholders are also low in relation to yields on other types of investments. The tax on an unrealized gain at the end of a five-year growth period would result in a net cash deficit to the investor, which would be an appropriation of his investment capital. (Exhibit "4"). In order to pay tax on unrealized gains, investors may be forced to sell part of their holdings. This would be especially undesirable if control passed for tax reasons to non-residents - a probable consequence of the taxation of Canadian residents on unrealized gains in their holdings of widely-held Canadian corporations.

The proposal to tax unrealized gains will work contrary to an equitable tax system. The principle as outlined in Section 1.8 of the Proposals, " — — — people in similar circumstances should carry similar shares of the tax load", will not be met. Based on stock market fluctuations, two investors, whether individuals or corporations, may be treated quite differently if the proposal to re-value their investments every five years, or a like period, is effected. One of the investors could be adversely affected if his birthday chances to fall in a period of high market values. (Exhibit "5"). The proposal would, therefore, appropriate one investor's capital while providing increased capital for a person in the same circumstances but with a different birthday. Stock market values could continue to fluctuate in a way in which this inequity may not be rectified over a lengthy period of time.

The proposal will from the start penalize foreign companies operating in Canada which have allowed Canadians to participate in their ownership. Provided that tax treaties

are revised to accommodate this proposal, foreign controlling shareholders of a Canadian public company would be subject to revaluation of their holdings every five years. Foreign shareholders owning a wholly-owned subsidiary in Canada, or a branch, would not be subject to the tax on unrealized gains.

If a non-resident operates in Canada through a Canadian holding company, or through a wholly-owned subsidiary, tax would be imposed on gains realized on share transfers which would allow Canadian participation in the operations. This proposal, therefore, encourages complete foreign ownership of companies.

We recommend deletion of the proposal to tax unrealized gains on shares of public companies.

D The Proposal to Increase Withholding Taxes on Interest Payments on Debt Capital

Canada relies on outside sources of capital for development. "External capital has always played a significant role in Canadian development. Indeed, scarcity of such capital has often put limits on the pace of Canada's expansion". (Canada-One Hundred, 1867-1967). "Investments of non-resident capital have been closely related to the high rate of growth in Canada and to the heavy demands placed on capital markets by this factor and by the financial needs of governments and municipalities. Large development projects have been initiated and financed by investors from other countries and the growth effects have, in turn, led to Canadian borrowing in capital markets outside Canada." (Canada Year Book 1968).

To the extent that it is important that Canadians retain proceeds and profits from Canadian resources, it would be in Canada's best interest if foreign debt capital could be attracted in those instances where foreign equity capital is a less desirable alternative.

Withholding taxes are a very important factor in determining interest rates and many Canadian borrowers must provide indemnification to foreign lenders who are unable to recover the taxes by way of foreign tax credits. As a result, the taxes effectively increase interest costs to Canadian borrowers and may tend to deter the attraction of debt capital to Canada. Increased interest costs will, in turn, decrease profits to Canadian shareholders and/or increase costs of goods and services to consumers.

The adverse effect which withholding taxes impose on debt issues is recognized by the Government in exemption of interest on federal, provincial and municipal government issues including government owned corporate issues, from withholding tax. If the tax did

not have an affect on the cost of borrowing to Canadians, there would be no reason to exempt these issues as the tax is imposed on non-residents and would otherwise not affect Canadian borrowers.

Withholding tax on debt capital is not a sufficiently important source of revenue in Canada to justify the restrictions which it imposes on debt capital. Total withholding taxes from all sources, including interest, dividends, rentals and royalties, amounted to only 2.02% of total budgetary revenues for the year ended March 31, 1969. The tax on interest on debt issues would be only a portion of this, and the small decrease in Government revenues as a result of exempting debt issues from tax would be partly offset by a decrease in deductible interest expense thereby increasing Canadian corporate tax yields. More important is the fact that withdrawal of the tax would result in an incentive to foreign investors to invest in debt rather than equity capital and provide a much broader market for Canadian corporate debt issues. (It is expected that the 10% withholding tax rate on dividends of companies with a degree of Canadian ownership would be retained as compared to rates of 15% and 25% on interest).

We, therefore, recommend that interest on debt capital be exempted from withholding taxes.

E The Proposal to Tax Realized Capital Gains

The proposal to tax capital gains in the year of disposition at full rates of tax, with the exception of gains in value of widely-held company shares taxed at 50% rates, creates an unduly high tax burden.

Assets which have been held over a period of years have appreciated in value over the length of the period. Imposition of tax at full rates does not recognize that the gain is "earned" throughout this period.

Also the full rates of tax do not recognize inflationary factors. The less the purchasing power of the dollar, the greater the incidence of tax. Tax should be applied to "real" gains only and not on inflationary gains.

We recommend that the Government re-consider its proposals to tax realized capital gains. If gains are to be subject to tax, we would recommend that gains realized on investments be subject to reasonably low rates of tax which will recognize appreciation and inflation factors.

F The Proposal to Revise the Base for Depletion Allowances

The Proposal to allow depletion on the basis of exploration and development expenses incurred will create a much higher tax burden on producers of oil, gas and minerals. This increased tax burden must be met by increased prices which could have an adverse effect, not only on domestic uses of these resource products, but on export markets.

Exploration and development of Canada's oil and gas reserves has been largely dependent upon foreign capital, and the present tax structure results in a direct incentive to development and production. Foreign capital necessary for this continued development may be invested in other countries if the after-tax yield on the investments is materially reduced.

The present depletion allowance to shareholders provides a direct incentive to Canadians to invest in petroleum and mining ventures. The continuance of this incentive is especially important in the light of the high foreign ownership factor of petroleum and mining companies.

We recommend that the present system of depletion be maintained and that depletion allowances to shareholders on dividends received out of production income be continued.

G The Proposal to Disallow Convention and Entertainment Expenses

The present Income Tax Act provides for taxation of personal benefits received in the course of employment or from a business. Expenses which are incurred to earn an employer's income should be allowed for tax purposes and not be treated as benefits.

We recommend that the proposal to disallow convention and entertainment expenses be deleted.

H The Proposal to Allow Tax Nothings

We commend the Government on its Proposal to allow as a deduction from income certain business expenditures which were previously non-allowable.

The definition of tax nothings should be very broad so as to allow all expenditures of operating a business including commissions on debt issues and foreign exchange. Un-amortized expenditures incurred in prior years but applicable to earning future income should also be allowed.

COMPARISON OF TAX TREATMENT OF
INVESTORS IN SHARES OF
VARIOUS PUBLIC COMPANIES
UNDER PROPOSED SYSTEM

	<u>Company with a Tax Deferral</u>	<u>Company Paying Normal Tax</u>
<u>Shareholders with a Marginal Tax Rate of 30%</u>		
Dividend	\$ 100	100
Taxable Credit	<u>—</u>	<u>50</u>
Taxable Dividend	<u>100</u>	<u>150</u>
Tax thereon	30	45
Tax credit	—	50
Tax Payable (Refund)	<u>30</u>	<u>(5)</u>
Cash income to investor	<u>\$ 70</u>	<u>105</u>
 <u>Shareholders with a Marginal Tax Rate of 40%</u>		
Dividend	\$ 100	100
Taxable credit	<u>—</u>	<u>50</u>
Taxable Dividend	<u>100</u>	<u>150</u>
Tax thereon	40	60
Tax credit	<u>—</u>	<u>50</u>
Tax Payable (Refund)	<u>40</u>	<u>10</u>
Cash income to investor	<u>\$ 60</u>	<u>90</u>

The present system of tax credits would afford equal treatment for these shareholders. They look to the public company as an entity separate from themselves and are primarily interested in their "net" cash return.

Exhibit 2

FLOW OF INCOME BETWEEN COMPANIES AND
ULTIMATELY TO AN INDIVIDUAL SHAREHOLDER

	Present System		Proposed System
<u>Subsidiary of TransCanada PipeLines</u>			
Net income of Subsidiary	\$ 200		200
Tax thereon	100	deferred	100
Distributable income	<u>100</u>		<u>100</u>
<u>TransCanada PipeLines</u>			
Dividend received by TransCanada	100		100
Creditable tax (100%)	—		—
	Exempt		100
Tax thereon		deferred	50
Tax credit			—
Tax paid by TransCanada		deferred	<u>50</u>
<u>Canadian Pacific Investments (shareholder of TransCanada)</u>			
Dividend received by Canadian Pacific	100		50
Creditable tax (50%)	—		—
Taxable Dividend	Exempt		<u>50</u>
Tax thereon at 33 1/3%			17
Tax credit			—
Tax paid by Canadian Pacific			<u>17</u>
<u>Individual Shareholders of Canadian Pacific</u>			
Dividend received by individual	100		33
Taxable credit	—		9
Taxable Dividend	<u>100</u>		<u>42</u>
Tax thereon (assume rate of 40%)	40		17
Tax credit	20		9
Tax paid by individual	<u>20</u>		<u>8</u>
<u>Summary</u>			
Total tax on income of \$ 200	<u>120</u>		<u>175</u>
Cash remaining for individual	<u>\$ 80</u>		<u>25</u>

It is noted that, if the first two companies are not paying full rates of corporate tax, the proposed system would provide an extremely high incidence of tax. Sufficient income must be retained in each company in order to pay taxes which are now deferred.

UNITED STATES TAX PROVISIONS FOR
CANADIAN SOURCE DIVIDENDS

	Shareholder		
	U.S. Company	Cdn. Company	
		Proposed	Present
<u>TransCanada Deferring Taxes</u>			
A United States company, owning more or less than 10% of TransCanada, would treat dividends received as follows in comparison to dividends received by a closely-held Canadian company.			
Gross dividend from TransCanada	\$ 500	500	500
Canadian withholding tax at 10%	50	—	—
Dividend received	<u>450</u>	<u>500</u>	<u>500</u>
Income	500	500	500
Less taxes (48% U.S.)	<u>240</u>	<u>250</u>	—
	<u>260</u>	<u>250</u>	<u>500</u>
Foreign tax credit received	<u>50</u>	—	—
Cash remaining	<u>\$ 260</u>	<u>250</u>	<u>500</u>

TransCanada Paying Full Tax

A United States company, if it owned 10% or more of TransCanada, would treat dividends paid by TransCanada, when TransCanada becomes fully taxable, as follows:

Income originating in Canadian company	\$ 1,000
Canadian income taxes thereon	<u>500</u>
Dividend declared	500
Withholding taxes at 10%	<u>50</u>
Net dividend payment to the United States company	<u>450</u>
United States taxable income	<u>1,000</u>
United States tax (48%)	<u>480</u>
Recovery of Canadian taxes (assume recovery to extent of U.S. taxes)	<u>480</u>
Cash remaining (compared to \$500 for a Canadian company under present or proposed system)	<u>\$ 450</u>

Full recovery, to the extent of the average rate of United States taxes, therefore may be made on Canadian taxes which would primarily offset the incidence of United States tax. (The present 10% U.S. surtax is omitted as it is temporary).

Exhibit 4

**COMBINED EFFECT OF PROPOSED DIVIDEND TAX
CREDIT SYSTEM AND TAX ON UNREALIZED GAINS ON GROWTH COMPANIES**

An investor buys 100 shares in TransCanada PipeLines on December 31, 1960 at a cost of \$1,900. The tax proposals would have resulted in the following during a five-year period:

	<u>TransCanada</u>
Dividends received - 1961 to 1965	\$ 200
Taxable credits	<u>—</u>
Taxable Dividend	<u>200</u>
Tax, assume 40% rate	80
Tax credit	<u>—</u>
Tax payable on dividends - 1961 to 1965	<u>80</u>
Cash return on dividends	<u>120</u>
Cost of investment	<u>1,900</u>
Value at end of 5 years	3,838
Taxable gain (½)	969
Tax @ 40% on unrealized gain payable in 1965	<u>388</u>
Net cash deficit to investor who retains stock after five-year period:	
Taxes - on accrued gain	\$ 388
- on dividends	<u>80</u>
Less dividends received	<u>200</u>
Net cash deficit	<u>\$ 268</u>

<u>Operating Results</u>	<u>1960</u>	<u>1961</u>	<u>1962</u>	<u>1963</u>	<u>1964</u>	<u>1965</u>
Net earnings on tax (\$000)	(2,911)	2,076	4,511	10,483	13,243	13,834
Average earnings per share	—	.35	1.03	1.52	1.99	1.87
Dividends (\$000)	—	—	—	—	7,059	7,573
Dividend per share	—	—	—	—	1.00	1.00
Market value December 31	19	266/8	214/8	346/8	393/8	383/8

UNEQUAL TREATMENT OF EQUAL TAXPAYERS AS A
RESULT OF THE PROPOSED TAX ON UNREALIZED GAINS
ON PUBLIC COMPANY SHARES

The following situations could result for either corporate or individual shareholders from Proposal 3.38:

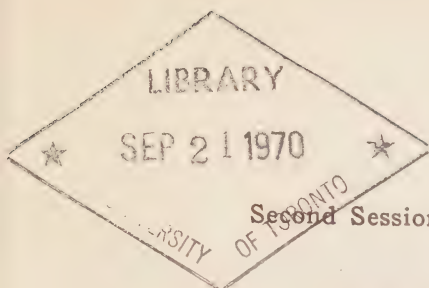
Investor "A" who is aged 35 in August, 1963 purchases 1,000 shares of a petroleum company at \$3.10. The value of the shares in August, 1968 is \$2.45.

Investor "B" who is aged 35 in December, 1963 purchases 1,000 shares of the same company as Investor "A" at \$3.10 in August, 1963. The value of the shares in December, 1968 is \$7.35.

The tax proposals would treat the two investors as follows:

	Investor "A"	Investor "B"
Cost of investment in 1963	\$ 3,100	3,100
Value for tax purposes in 1968	<u>2,450</u>	<u>7,350</u>
Unrealized gain (loss)	<u>(650)</u>	<u>4,250</u>
Tax gain (loss)	<u>(325)</u>	<u>2,125</u>
Tax (refund) assuming 40% marginal rate	<u>\$ (130)</u>	<u>850</u>

It is noted that the shares of this company closed in 1969 at a value of \$3.75. The appropriation of Investor "B's" capital, therefore, provides increased income to a person in similar circumstances, Investor "A". In the event that Investor "B" was unable to raise sufficient cash to pay his tax, he may be forced to sell his investments, and this sale could occur when the value is much lower. Individuals or corporations may also be forced to relinquish controlling interests. Although it may be argued that the inequity would be corrected over a long period of time, this is not necessarily true. The individuals' tax rates may be considerably lower when a sale or future revaluation occurs, and if the share values are at a low value, a tax recovery on a reported loss would not offset the appropriation of capital which has occurred in the above example.



Second Session—Twenty-eighth Parliament
1969-70

THE SENATE OF CANADA

PROCEEDINGS OF THE STANDING SENATE COMMITTEE ON **BANKING, TRADE AND COMMERCE**

The Honourable **SALTER A. HAYDEN**, *Chairman*

No. 35

Thursday, June 18, 1970

Twenty-Ninth Proceedings on the Government White Paper, entitled:
"PROPOSALS FOR TAX REFORM"

WITNESSES:

(For list of witnesses see Minutes of Proceedings—Pages 35 : 5)

APPENDICES:

- "A"—Brief from the Canadian Bankers' Association.
- "B"—Brief from The Board of Trade of Metropolitan Toronto.
- "C"—Brief from The Mining Association of Canada.
- "D"—Brief from The Canadian Life Insurance Association.
- "E"—Brief from the Insurance Bureau of Canada.
- "F"—Letter from the Minister of Finance, dated June 11, 1970,
to the Honourable **Salter A. Hayden**, *Chairman*.

THE STANDING SENATE COMMITTEE ON
BANKING, TRADE AND COMMERCE

The Honourable Salter A. Hayden, *Chairman*

The Honourable Senators:

Aird	Croll	Isnor
Aseltine	Desruisseaux	Kinley
Beaubien	Everett	Lang
Benidickson	Gélinas	Macnaughton
Blois	Giguère	Molson
Burchill	Grosart	Phillips (<i>Rigaud</i>)
Carter	Haig	Walker
Choquette	Hayden	Welch
Connolly (<i>Ottawa West</i>)	Hays	White
Cook	Hollett	Willis—(30)

Ex officio members: Flynn and Martin

(Quorum 7)

ORDERS OF REFERENCE

Extract from the Minutes of the Proceedings of the Senate, November 19, 1969:

“With leave of the Senate,

The Honourable Senator Martin, P.C., moved, seconded by the Honourable Senator Langlois:

That the Standing Senate Committee on Banking, Trade and Commerce be authorized to examine and report upon the White Paper intitled: “Proposals for Tax Reform”, prepared by the Minister of Finance, and tabled in the Senate on Tuesday, 18th November, 1969.

After debate, and—

The question being put on the motion, it was—

Resolved in the affirmative.”

Extract from the Minutes of the Proceedings of the Senate, December 19, 1969:

“With leave of the Senate,

The Honourable Senator Phillips (*Rigaud*), moved, seconded by the Honourable Senator Robichaud, P.C.:

That the Standing Senate Committee on Banking, Trade and Commerce be empowered to engage the services of such counsel and technical, clerical and other personnel as may be necessary for the purposes of its examination and consideration of such legislation and other matters as may be referred to it.

After debate, and—

The question being put on the motion, it was—

Resolved in the affirmative.”

Extract from the Minutes of the Proceedings of the Senate, February 18, 1970:

“With leave of the Senate,

The Honourable Senator McDonald moved, seconded by the Honourable Senator Hayden:

That the Standing Senate Committee on Banking, Trade and Commerce have power to sit during adjournments of the Senate.

After debate, and—

The question being put on the motion, it was—

Resolved in the affirmative.”

ROBERT FORTIER,
Clerk of the Senate.

MINUTES OF PROCEEDINGS

THURSDAY, June 18th, 1970.
(56)

MORNING SITTING

Pursuant to adjournment and notice the Standing Senate Committee on Banking, Trade and Commerce met this day at 9:00 a.m. to further consider: The Government White Paper entitled: "Proposals for Tax Reform".

Present: The Honourable Senators Hayden (*Chairman*), Aird, Aseltine, Beaubien, Blois, Burchill, Carter, Connolly (*Ottawa West*), Cook, Gelinas, Haig, Hollett, Isnor, Kinley, Molson, Phillips (*Rigaud*), Welch and Willis—(18).

WITNESSES:

The Canadian Bankers' Association:

Mr. René Leclerc, President, CBA, Vice-President, Director and Chief General Manager, La Banque Canadienne Nationale;
Mr. J. K. Finlayson, Vice-President, CBA;
Mr. J. H. Cornish, The Royal Bank of Canada;
Mr. M. G. Clennett, The Royal Bank of Canada;
Mr. M. H. Maltby, Canadian Imperial Bank of Commerce;
Mr. S. A. Shepherd, The Bank of Montreal;
Mr. N. E. Currie, The Bank of Montreal;
Mr. A. B. McKie, The Bank of Nova Scotia;
Mr. D. D. Peters, The Toronto Dominion Bank;
Mr. J. Machabee, The Provincial Bank of Canada;
Mr. J. Boulanger, Banque Canadienne Nationale;
Mr. S. Sarpkaya, CBA.

Board of Trade of Metropolitan Toronto:

Mr. J. W. Kerr, President, Board of Trade, Chairman and Chief Executive Officer, TransCanada PipeLines Ltd.;
Mr. D. S. Anderson, 1st Vice-President, Board of Trade, Director and Senior Vice-President, Royal Bank of Canada;
Mr. P. T. Clark, F.C.A., Chairman, Board of Trade Taxation Committee—Comptroller of Revenue for Ontario—1948-1963. Now in private practice as a Tax Consultant;
Mr. S. E. Edwards, Q.C., Member of Board of Trade Taxation Committee. A partner in the Fraser & Beatty law firm;
Professor S. Friedland, Economic Advisor to Board of Trade Taxation Committee. Director of Capital Markets Research, York University;
Mr. J. K. Gibson, F.C.A. Member-elect of Board of Trade Council. Past Chairman and member of Board of Trade Taxation Committee. Partner of Clarkson, Gordon & Co.;
Mr. R. M. Wingfield, C.A. Member Board of Trade Taxation Committee. Associate of Arthur Andersen & Co.;

Mr. J. W. Wakelin, General Manager, Board of Trade;
Mr. T. G. O'Connor, Legal Secretary, Board of Trade.

The Mining Association of Canada:

- Mr. J. Kostuik, President of the Association and President of Denison Mines Limited. (Mr. Kostuik is also a member of the National Advisory Committee on Mining and Metallurgical Research, and Chairman of the Mining Research Sub-Committee of that national body);
Mr. C. R. Elliott, Chairman of the Tax Committee, a member of The Executive Committee of the Association and President of Conwest Exploration Co. Ltd.;
Mr. D. B. Craig, Member of the Tax Committee of the Association and Tax Manager of The International Nickel Company of Canada, Limited;
Mr. D. H. Ford, Member of the Tax Committee of the Association and Director of Taxation of Noranda Mines Ltd.;
Mr. V. St-Onge, Member of the Tax Committee of the Association and Tax Manager of Quebec Cartier Mining Co.;
Mr. J. L. Bonus, Managing Director of the Association;
Mr. J. K. Gibson, Partner, Clarkson, Gordon & Co.

At 12:40 p.m. the Committee adjourned.

AFTERNOON SITTING

2:15 p.m.
(57)

At 2:15 p.m. the Committee resumed.

Present: The Honourable Senators Hayden (*Chairman*), Aird, Aseltine, Beaubien, Blois, Burchill, Carter, Cook, Haig, Hollett, Isnor, Kinley, Molson, Phillips (*Rigaud*) and Welch—(15).

WITNESSES:

Canadian Life Insurance Association:

- Mr. Hervé Belzile, President
President, Alliance Mutual Life Insurance Company, Montreal;
Mr. E. G. Schafer, Past President
President, The Dominion Life Assurance Company, Waterloo;
Mr. J. A. Rhind, President, The National Life Assurance Company of Canada, Toronto;
Mr. W. J. Adams, Vice-President, The Equitable Life Insurance Company of Canada, Toronto;
Mr. T. R. Suttie, Executive Vice-President, The Equitable Life Insurance Company of Canada, Waterloo;
Mr. E. H. McVitty, General Counsel, The Manufacturers Life Insurance Company, Toronto;
Mr. J. W. Popkin, Senior Economist, Sun Life Assurance Company of Canada, Montreal;
Mr. R. D. Radford, Associate Treasurer, The Canada Life Assurance Company, Toronto;
Mr. G. C. Campbell, Tax Consultant of the Association, Toronto;
Mr. J. A. Tuck, Managing Director of the Association, Toronto;
Mr. F. C. Dimock, Secretary of the Association, Toronto.

Insurance Bureau of Canada:

Mr. E. H. S. Piper, Q.C.;

Mr. D. Atkins, C.A.;

Mr. C. G. Angas.

The Honourable J. Campbell Haig *Acting Chairman* in the Chair.

Ordered: That the documents submitted at the meeting today be printed as appendices to these proceedings, as follows:

A—Brief from The Canadian Bankers' Association.

B—Brief from The Board of Trade of Metropolitan Toronto.

C—Brief from The Mining Association of Canada.

D—Brief from The Canadian Life Insurance Association.

E—Brief from the Insurance Bureau of Canada.

F—Letter from the Minister of Finance, dated June 11th, 1970, to the Honourable Salter A. Hayden, *Chairman*.

At 4:00 p.m. the Committee adjourned to the call of the Chairman.

ATTEST:

Frank A. Jackson,
Clerk of the Committee.

THE STANDING COMMITTEE ON BANKING, TRADE AND COMMERCE

EVIDENCE

Ottawa, Thursday, June 18, 1970. [Translation]

The Standing Senate Committee on Banking, Trade and Commerce met this day at 9.00 a.m. to give further consideration to the White Paper entitled "Proposals for Tax Reform".

Hon. Salter A. Hayden (*Chairman*) in the Chair.

The Chairman: Honourable senators, I call the meeting to order. We have a number of briefs today. The first group we are going to hear is The Canadian Bankers' Association.

Before we hear them, I have had distributed to every member of the committee a letter which was addressed to me by the Minister of Finance and which was also tabled in the House of Commons. I think it should be made part of the proceedings of today.

Hon. Senators: Agreed.

The Chairman: I am sure you have all read the copy. I think the pertinent paragraph—and you can accept this view or not, as you like—is that he wanted to make it crystal clear that the White Paper was to reform, to have tax reform and not tax increases.

However, in passing, if you read the White Paper itself, it proposes tax increases; and if you read any speeches which Mr. Bryce made, including one to The Banking Institute, he was indicating how the extra money might be disposed of or spent. So I do not think there are any illusions. If the Government gets money, it will spend it somehow. However, it is part of the record now, and we will take it from there.

We have The Canadian Bankers' Association, whose spokesman is Mr. René Leclerc, the President of The Canadian Bankers' Association. He is going to make the opening statement, and then he will introduce his panel. Then, whatever the features are that they wish to emphasize, we will pick them up from there.

Of course, Mr. Leclerc, you know that at any time you can call on any member of your panel to answer a question. Now, will you proceed please?

Mr. René Leclerc, President, The Canadian Bankers' Association: Mr. Chairman, honourable senators, The Canadian Bankers' Association represents those banks which operate pursuant to the Bank Act. We are very pleased to be present before the Committee today to submit our views on certain of the proposals for tax reform, and hope that the discussion will be fruitful.

[Text]

I should like first to present my colleagues. My principal associates are: Mr. J. K. Finlayson, next to me, the Vice-President of our association and a Vice-President, Director and Chief General Manager of the Royal Bank of Canada; and Mr. J. A. Boyle—who is replacing Mr. Thomson—the Deputy Chief General Manager, Toronto Dominion Bank.

Other members of our delegation are: Messrs. J. H. Cornish and M. G. Clennett of The Royal Bank of Canada; Mr. M. H. Maltby, Canadian Imperial Bank of Commerce; Mr. S. A. Shepherd, Bank of Montreal; Mr. A. B. McKie, The Bank of Nova Scotia; Mr. D. D. Peters, The Toronto Dominion Bank; Mr. Jean Machabée, The Provincial Bank of Canada; Mr. Jean Boulanger, Banque Canadienne Nationale; Mr. Suleyman Sarpkaya, of The Canadian Bankers' Association; and, of course, myself, Vice-President, Director and Chief General Manager of La Banque Canadienne Nationale.

I make no claim to being a tax expert, and I propose to lean rather heavily on my colleagues today in presenting our views and in responding to your questions. Let me say that the banks are as concerned by matters of tax policy as are all other Canadian organizations.

We have been studying the White Paper Proposals since last November. We have also studied some of the background papers released by the Minister of Finance. But our views and our recommendations are based solely on what is proposed in the White Paper. Our conclusions are contained in the submission now in your hands and I do not believe it would be useful for me to attempt a detailed review at this time.

[Translation]

We are interested, not only as large taxpayers, but also for our millions of clients, our hundreds of thousands of share holders and employees, and for a sound Canadian economy.

The ten chartered banks operate some 6,100 branches in Canada and some 300 in thirty-five foreign countries. At 31st March 1970 their assets totalled more than \$32,000 million of which 29 per cent was in foreign currency.

The banks employ approximately 92,000 people. At 31st October 1969, the chartered banks had 173,466 share holders of which 93 per cent were Canadian residents and held 95 per cent of the shares. The chartered banks have more than 20 million depositors in addition to having made loans to almost four million borrowers.

[Text]

These figures indicate quite effectively, I believe, that we have a deep and continuing interest in the national welfare, as in the welfare of the individuals which comprise the nation, the large majority of whom are our customers. We are conscious that we depend for our growth and progress on the parallel growth and progress of the economy. We know that the economy is influenced by the tax regime.

For these reasons, our brief concentrates on the potential economic effects of the reforms now proposed, although we recognize and support fully the other goals set out in the White Paper.

[Translation]

According to our philosophy, the fiscal system should encourage initiative as much of the individual as of business, and in a manner in which Canada can participate more in international expansion. We favour a uniform and efficient system permitting dynamic growth. We believe that without such growth Canadians would not attain the standard of living to which they aspire. Thank you Mr. Chairman.

[Text]

The Chairman: Mr. Leclerc, do any members of your delegation wish to add anything, or are they ready for questions?

Mr. Leclerc: We are ready for your questions.

Senator Phillips (Rigaud): Mr. Chairman, I think that the best way to start the questioning is to indicate to the gentlemen present that the first item we should like to clear up is the subject matter of integration, as it is dealt with in the White Paper. We

should like to know the attitude of the Bankers' Association with respect to it. In the process of so doing we can deal with the other matters in the context or otherwise of the integration system proposed by the White Paper.

I notice that in your brief you clearly indicate that you are not in favour of the integration system. In dealing with the retention of the present system of corporate taxation and shareholder tax credits you indicate that there may be room for some revision of the treatment of tax credits.

The first question I should like to put to you is: If we abandon integration as contemplated by the White Paper, and if we retain the present system of tax credits, what improvements or modifications would appeal to your association?

Mr. M. H. Maltby, (Canadian Imperial Bank of Commerce), The Canadian Bankers' Association: In paragraph 28 we suggest that an improvement could be made by making available refunds where the dividend tax credit exceeds the taxpayers' liability, and possibly by introducing a graduated scale of credits where the graduation would permit a greater dividend tax credit for the small receipt of dividends, not unlike that adopted in Ontario.

Senator Phillips (Rigaud): You give that by way of example. You sort of suggest that it might well be desirable to make improvements—that word is in the plural—and then you refer to that particular instance. Just to follow through on it, and to assist you in your reaction, I would say that it has been suggested in some of the briefs and representations that have been presented to us that a reduction in the corporate rate and an increase in the tax credit from 20 to 25 per cent—and some taxpayers have suggested 30 per cent—would bring us closer to the concept of an equity relationship which is being striven for by the proposals in the White Paper. What would be your reaction to that?

Mr. Maltby: My first reaction would be that that could well be true.

Senator Phillips (Rigaud): Could we have a corporate reaction from the Bankers' association which is, after all, a very important association. This committee is under obligation to believe in either the integration system or the retention of the present tax credit system, or the revision of the latter, and we are looking for guidance and an expression of your views.

Mr. Maltby: In part, sir, there is the difficulty of the integration proposed, and the fact that it is unfavourable to Canadian multi-national companies and

others who benefit—I am trying to find the correct word— by tax concessions, or by deliberate incentives within the tax structure. They would be partly wiped out under the integration system because the Canadian tax on the corporation would be lowered thereby and, therefore, the creditable tax to the Canadian shareholder—

Senator Phillips (Rigaud): That is not quite an answer to my question. About 90 per cent of the taxpayers who have appeared before us are critical of the integration proposed by the White Paper to a greater or lesser degree, and we are now trying to crystalize our view. What is your view of the present system, if any, or do you simply say that the present system is the right one, apart from the specific reference that you have made in paragraph 28 on page 27 of your brief?

Mr. Maltby: Yes, sir, I think that is our view.

Senator Phillips (Rigaud): That would be about it?

Mr. Maltby: Yes.

The Chairman: Can we follow that up for a moment? The White Paper says that the present system should be discarded because some taxpayers get dividend tax credits, and the companies that pay the dividends do not pay taxes. Do you think that that is a valid objection?

Mr. Maltby: I think that many, if not most, of the exemptions that are granted to corporations that do not pay tax are intended to be received back from the shareholders.

The Chairman: My question is: Do you regard that as being a valid objection—valid enough that you would discard the system?

Mr. Maltby: No, I do not.

The Chairman: Would you favour an extension of this dividend credit rule under which you would except from the benefit of it the dividends which come from companies which have not paid corporate tax?

Mr. Maltby: No.

Senator Connolly (Ottawa West): Why?

Mr. Maltby: They have not paid tax because of an incentive that was deliberately given to them.

Senator Connolly (Ottawa West): And what about the dividend that is received by the shareholder?

Mr. Maltby: It is an incentive granted to the corporation, and it is meant to get back to the shareholder.

Senator Connolly (Ottawa West): In other words, you look upon it as an incentive for Canadians to invest in Canadian corporations?

Mr. Maltby: Yes.

The Chairman: If you give an incentive to a corporation, as the result of which its taxable income is lower, and, therefore, the tax credits are less, and then you do not give the right to the shareholder to deduct the tax credit, then you are giving with one hand and taking away with the other. That seems to me to be a logical way of looking at it.

Mr. Maltby: Yes.

The Chairman: You would agree with that?

Mr. Maltby: Yes.

The Chairman: Therefore, you are against any qualification, and you are for a tax credit, pure and simple, of, say, 20 per cent.

Mr. Maltby: I do not think there should be any qualifications.

The Chairman: I think you have mentioned some of your objections to integration. We have had quite a recital of them here, having heard well over a hundred briefs. You have mentioned two of the really critical ones.

In the mining industry whatever incentives that get as a result of it, the creditable tax that the shareholder would enjoy is substantially less.

Canadian-based multinational companies have complained because the exposure of their foreign source income to tax would seriously affect their position and the continuation of their operations from a Canadian base.

You recognize that as being one of the real objections.

Mr. Maltby: Yes, we do.

Senator Phillips (Rigaud): I would like to discuss the small business, which is dealt with at pages 28, 29 and 30 of your brief.

We think, gentlemen, that you are highly competent and authoritative to respond to questions under that heading. We have studied this matter in depth. Some of the honourable senators entertain the view that it would be desirable to retain an incentive or benefit for small businesses.

I can only speak for myself, but some of us are down to the point of attempting to identify what is a small business. We are having problems in relation to sales, capital employed, profits or a combination of those factors, and others.

We would like to have your views on the following headings: one, what would be your suggestion as to what is a small business from the point of view of the proposed retention of the lower rate of 21 per cent up to \$35,000?

Secondly, do you think that the lower rate, if suggested, should be given to all corporate taxpayers, regardless of size of business?

Thirdly, if the concession of the lower rate is made, should that be given in terms of mere deferment of tax liability up to the normal corporate rate, such deferment to be eliminated when the profits in respect of which there has been deferment are distributed by way of dividend to the shareholders of the small business? I am speaking in the context of this question obviously of a corporate small business as distinct from an individual or partnership.

Mr. Leclerc: The Association attempted to define small business but has not succeeded in finding the real answer. We are still studying this point.

Senator Phillips (Rigaud): Would you say, Mr. Leclerc, that the benefit of the lower rate given to small businesses, accepting for the moment your view of the difficulties of finding such a definition, were eliminated it would seriously impair the credit standing of small businesses and their lines of credit available from the banking business of the country?

Mr. Leclerc: In our view it will affect the small businesses. I do not know if we will base it on sales or profits, but it will surely affect the small business if that rate is raised to around 50 per cent.

The Chairman: Mr. Leclerc, it is quite obvious from the information we have been given that about the

only source of capital for small business is their retained earnings.

Mr. Leclerc: Yes.

The Chairman: In other words, the investor does not regard the small business generally as an attractive investment.

Mr. Leclerc: No.

The Chairman: That was the purpose in giving the lower rate of tax originally back in 1949. It appears to some of us that the only way we can benefit the small businessman in a real manner is by giving him a lower rate of corporate tax so that he can retain more of his earnings.

Some suggestion has been made with reference to giving higher capital cost allowances. However, that does not appear to be the answer.

The making of loans is part of your business, but they still have to find the money to repay them.

Mr. Leclerc: Yes, and they still have to make profits or put more capital into their business.

The Chairman: Yes. I would say if we counted the number of briefs that have referred to small businesses, and most of them did, well over a majority favour the definition of a small business by relation to the net profits. The suggestion has been that possibly \$75,000 would be a fair measure by which to classify a small business.

Mr. J. K. Finlayson, Vice-President, The Canadian Bankers' Association: In direct answer to Senator Phillips' question, if this tax benefit, so called, did not exist, it could affect the credit levels of small business. It would represent lower capitalization because of the lesser opportunity to accumulate profits.

Senator Molson: Your brief at page 30 appears to be in agreement with your suggestion that the lower rate be available to small but not big business, Mr. Chairman.

Therefore it is merely a question of attempting to establish mechanics to achieve this. There would certainly have to be some notch provision.

The Chairman: A measure of the extent of the influence on small business if the lower rate were removed is contained in figures produced here. They

show that the increase in revenues contemplated by abolishing the lower rate in relation to small business would amount to something in the order of \$400 million.

Translating that into terms of business, the savings of those people and retained earnings which are put into their business determines what effect it would have on their operations.

Mr. Finlayson: There is also the aspect that small business quite often has a higher risk element than large business. This is due to inadequate management skills and so on. There is an entrepreneurial aspect to it. They need to accumulate a reasonable capital from oftentimes an undercapitalized basis.

There is an incentive and an incentive is needed today for a small man to start a business on his own. He faces great risks, an 80-hour week, and so forth. These factors should be recognized.

The Chairman: No one has answered the part of Senator Phillips' question relating to the fact that at the lower rate more of the earnings are permitted to remain in the company.

What is your view as to the payment of those earnings out of small business? Do you think they should be subject to the marginal rate of the person who receives it?

Mr. Finlayson: My personal feeling is yes, drawings should be subject to tax.

Senator Phillips (Rigaud): Of course, but should there be payment of a corporate tax which, in a sense, had been deferred?

I am obviously not speaking of the tax rate of the individual, but the case of the corporate rate being 21 per cent in lieu of 50 per cent? If the surplus resulting from such lower rate were distributed, would there be exigible a corporate tax bringing it up to the rate that was in force applicable to all corporations? That is the question. Incidentally, I am indebted to Senator Molson, and I apologize to these gentlemen, because on page 30 there was the answer to the question, that you are suggesting the benefit to small businesses only and not to corporations at large.

Mr. M. G. Clennett, (The Royal Bank of Canada), The Canadian Bankers' Association: The proposition with regard to the three questions which arises initially on whether there should be relief for small business by way of taxes, is that it was predicated that if we

provide such relief in the tax system, this will enable the small businesses to grow through their retained earnings, using these to develop into larger businesses. This, of course, we support. Most big businesses in Canada today were small businesses once, and they grew by building up their capital and their resources. We therefore support the proposition that they should have assistance.

If I may change the order of the senator's questions, the third one was: should this relief be extended to large businesses? We have answered this on page 30 of our brief; that is covered.

The other question is: what would happen if a small business, having had this advantage, were then to distribute part of the earnings on which it had had relief?

I think there are two facets to the question. One concerns the technical problems. This might create some technical problems, which, not having had advance notice of the question, I think we should reserve judgment on, except to note that there would be problems in keeping track of it.

Senator Phillips (Rigaud): You mean imputation of the dividend, to what part of the surplus?

Mr. Clennett: That is right, and other expenditures or records of the company, and so on.

However, in principle and in logic, if we say the reason we are giving this relief is to enable the earnings to be retained, to build it up, having distributed the retained earnings it would seem the business has decided for itself that it does not need any new business.

The Chairman: Is the conclusion, then, that we should go back and collect additional tax to bring the low rate up to the regular corporate rate?

Mr. Clennett: I think a move in that direction would have to be considered, and in this direction we are addressing ourselves only to the taxation features. In our brief and in our work we also favour any other aids that the Government has through its departments, or should put together, to assist small business; but we are here to talk only on tax questions.

The Chairman: I think the small businessman, if he were subjected to that sort of retroactive claim for additional corporate tax, might then think it was a form of Indian giving. Is it reasonable to look at this

on the basis that there is a lower corporate rate of 21 per cent, the business is entitled to it, and when they disentitle themselves by getting out of line they are no longer entitled to the low rate. There is that approach, rather than saying you go back and bring their rates up to the full corporate rate.

Mr. Finlayson: That would only occur when they pulled some money out.

Senator Isnor: I think the foundation of this is the definition of "small business", and I believe we should begin there. I would regard the Canadian Bankers' Association as in perhaps the best position of any of the witnesses we have had before us to give such a definition, because a small businessman as a rule has to go at some time or other to the bank to borrow. How would the bank assess the standing of that firm, a small firm? Is it the turnover or is it the net profit? I am inclined to think it is the net profit. Or perhaps both. In any case, I think this association is in a position to give us a definition such as we have been seeking ever since we started our hearings. Could we get a firm definition from the Bankers' Association?

Senator Molson: Perhaps it is turnover.

Senator Isnor: It is not the turnover that the bank will look at, because one firm might come to the bank with \$300,000 and another with \$1 million; the bank would on examination perhaps find that the firm with the \$1 million turnover had made only \$35,000, whereas the firm with \$300,000 turnover might have made an equal amount through showing better judgment and better business sense. I think that is what the bank would look at. Can we have a definition from the association?

Mr. Finlayson: I am not sure that we will be able to give you a definition. I wanted to make the point that in banking, in lending to small business it has never been necessary for us to identify absolutely what is a small business as compared to a medium and a large business, except that we have in the past used a rule of thumb approach in lending to small business, when trying to look after their needs in a tight money situation, and so on; we would use perhaps a company with a credit line of \$100,000. This, depending on the type of company, the type of security and so on, might indicate that a company with a net worth up to \$100,000 would certainly be considered a small business. On the other hand we go above that too, and today I think, as Senator Phillips indicated in your earlier discussions on it, you have come to the

conclusion that you would have to take a number of features into account, total sales level as well as net worth.

Senator Isnor: What are those features?

Mr. Finlayson: Total sales as well as net worth in the business, the ownership, whether it is owned by one man or two or three brothers, or something of this nature; in other words, it is a small business in that context. In trying to define it, I think you would have to segregate the small business into manufacturing, service industries, extractive industries, and so on, trying to reach some conclusion. If you went only on net worth, when a small business gets to the point of being almost large, the owner can just split it and have two companies, and he has two small businesses. As you know, you can multiply this. Therefore, in just using that aspect you could always keep within the 21 per cent bracket.

Senator Isnor: It seems to me that we must get a definition that goes beyond that. If I come to you for a loan you look at my last statement, the type of business I am doing, how long I have been in business, my progress and so on. What I want is a definition so that in future we will be able to deal with the so-called small business.

The Chairman: Senator Isnor, we will see what we can do and keep working at it.

Senator Isnor: I know, but we have been trying right along.

The Chairman: I put a proposition awhile ago but I am not satisfied that I got the answer I was looking for. I suggested a simple test and not a complicated one. The recital you gave would be complicated and detailed, but administratively do you not want the problem to be simple? If you are looking for one factor in a business to determine whether the business is classified as small or large, what factor would you pick?

Mr. Finlayson: I would pick net worth, not net profit. This can go up and down. This is what I would do if I had only one choice. Net profit does bring you in line with the \$35,000 you are thinking about when you have comparable figures.

Senator Phillips (Rigaud): The danger of net worth is that a small business so classified would be subject to the disincentive of making money. Incidentally, on

the question of more than one corporation being formed in order to get the benefit of the lower rates, the present tax laws would cover that on the tax minimization section.

Senator Beaubien: I would like to make a suggestion for the bankers' consideration. Supposing we had a notched provision so that earnings of up to \$35,000 would pay 21 per cent; \$36,000 to \$45,000, 26 per cent; \$46,000 to \$55,000, 31 per cent; \$56,000 to \$65,000, 38 per cent; and \$66,000 and up, 51.3 or whatever the actual rate is. What would the bankers think about that? This would take away the benefit from the big companies and retain it for the small companies.

Mr. A. B. McKie, (The Bank of Nova Scotia), The Canadian Bankers' Association: We live with that in other countries, such as Puerto Rico. This is a classic example, I suppose, of a graduated corporate scale.

There really should be some kind of a test in the Income Tax law. We know this is not a banker's view when he is looking at credit, but at the moment we are looking at the income tax and it seems to be that if you are looking for a simple test, then undoubtedly taxable income is a simple one. Certainly if you are going to keep corporations separate from the shareholders in a graduated scale of corporate taxes worthy of consideration it would be nothing novel, because we operate in the international field.

Senator Molson: I am talking about the possibility of the imposition of tax on the amount of pay-outs from small companies. Would it be unreasonable to have some application similar to section 105? I do not know why it would be particularly complicated. In the event there was a pay-out of earnings at a later stage, after the company had benefited from the lower rate, 15 per cent would apply as exists under section 105. It would not seem to be impossible. It might get around the problem.

Mr. Clennett: I am pleased that the senator raised the question, because I was not quite satisfied that I had properly expressed an opinion when the question was raised earlier. This is another version of the same point of requiring somebody who has received what is deemed to be a benefit to pay for it later with the problems or disadvantages, and it would seem to be a sort of a punishment. It would also add to the administrative difficulties. In terms, perhaps, of purity of tax accounting, it would be a desirable move, but in terms of being practical and understood I would think the suggestion such as the previous senator advocated,

with a notch rate would be more appropriate. You decide whatever benefit is appropriate and it is cleaned up and dealt with. Having done that your tax problems are then solved. Again, these are small businesses. They are not in a position to deal with complicated and sophisticated accounting.

The Chairman: If you did not have some basis for taxing the surplus that would accumulate, you really would be accumulating a tax-free surplus and the proprietor could do anything he would like after he paid the 21 per cent tax.

Senator Phillips (Rigaud): I did not think there is any question that the shareholder in a small business should be taxed if he capitalizes on section 105.

The Chairman: The question is: if a small business wants to take the money by way of dividend should there be a tax imposed on the company, quite apart from the shareholder who receives the dividends? We are all agreed that the shareholder who receives the dividends should be subject to whatever the going rate is for him. The other one is the surplus which is accumulated as a result of the lower rate of corporate tax and whether there should be a levy on that when it is paid out.

Senator Phillips (Rigaud): I think effectively we are getting the answer that there should not be.

The Chairman: Senator Beaubien made the suggestion it would involve the 15 per cent rate.

Senator Phillips (Rigaud): That is applicable to all corporations. It is not related to the subject matter of small businesses. That is simply a method of distributing surpluses in corporations without drawing distinction between small businesses and large businesses.

Senator Molson: The only thing is if you made a special application to small businesses, in the event they paid out and attracted a higher rate, you would be preventing the application of section 105.

Senator Phillips (Rigaud): You would not be preventing the application, but minimizing the benefit heretofore given.

Senator Cook: The only thing to do is to delete the dividend tax credit paid out and take away the 20 per cent.

The Chairman: Let us try to keep it simple.

Senator Connolly (Ottawa West): I would like to go to a more fundamental point. I think these witnesses can help us a good deal on this. Ten years or more ago Parliament was greatly agitated, as well as the press and the public, about the importance of trying to help small businesses. There seemed to be a complete mental roadblock about how to do it. One of the devices used were certain provisions we now have in the Income Tax Act. There were other things such as the Small Business Loans Act that were made available even for modernizing store fronts and things such as that. There must have been some effect, for the flowing from this legislation was noticeable to the banking institutions of this country.

Do these witnesses find that the provisions in the White Paper would be detrimental to small businesses, as they are perhaps not defined but at least described in the Income Tax Act?

Mr. Finlayson: The special type of loans we have had available for small business, as such, have not been taken widely by small businesses. I think the ordinary type of credit which the banks make available to small business seems to have filled the bill generally.

The Chairman: You mean there has not been much use of the Small Business Loans Act?

Mr. Finlayson: Yes. As far as direct lending and so on, because it is very complicated in the types of security and qualifications. When you are lending to a small business against receivables or inventories or something in a normal way, it seems to have taken care of most of the requirements.

Senator Carter: Is it not one of the reasons why small businesses have not made much use of the legislation, that it is available only for certain activities of small businesses and it does not meet the most urgent need of small businesses, being available only for building new plants or extensions of present facilities?

Mr. Finlayson: I think there is a restriction as to total sales, and for that reason they do not qualify.

Senator Carter: But they cannot get loans for industry, it is prohibited, and it is useful only for certain purposes, and these are not the most urgent needs of small business.

The Chairman: That may be a good reason why the act has not been made use of more generally.

Senator Connolly (Ottawa West): To come back to the basic proposition, the attempt made through the Small Business Loans Act to help small businesses has not been too successful. If the argument that small businesses should be helped is a valid one, as it was here in Canada when the act was introduced ten years ago . . .

The Chairman: 1949—20 years ago.

Senator Connolly (Ottawa West): It has never been satisfactorily solved, it would appear that the White Paper is going to brush out whatever advantages, whatever help, has come through the years to the small business community. Is that so?

The Chairman: Senator, it seems to me that we have shaken about all there is to be shaken out of the subject of small business, it would appear that the witnesses have gone as far as they are prepared to go. Could we move on to another subject?

Hon. Senators: Agreed.

The Chairman: We could deal with capital gains now and get the reactions of the witnesses.

The general question that we ask in connection with capital gains is, if we must have a capital gains tax, should it be by separate statute?

Mr. Leclerc: Mr. Maltby can answer that one.

Mr. Maltby: I wondered, sir, what the proposal is—a separate statute, separate tax situations, rather than part of taxable income?

The Chairman: No, we are not talking about taxing it as income, but as taxable gains similar to the United States.

Mr. Maltby: I see. If it is not being taken in as taxable income, the only question then is whether it is by a separate statute. It would be taxed separately, at any rate?

The Chairman: Yes, taxed separately. I qualified it, because a lot of representation here as to Canada's need for savings and investment is such that there should not be any capital gains tax. But it looks as though the economics have been passed over and we have got into a political issue, that it is a source of money that has not been exploited and therefore it should be exploited in some fashion.

Mr. Maltby: I could say that the banks would see some dangers and disadvantages in the situation.

The Chairman: Senator Phillips, your question, that you have been raising.

Senator Phillips (Rigaud): Yes, Mr. Chairman, this is the question I should like to put. It has been suggested that we should start off on a more or less cautious basis in the introduction of a capital gains tax, and rather than tying a capital gains tax to all assets, that is to say, to the profits thereon, and providing for certain exemptions—that we proceed in reverse, that we simply submit capital gains to taxation in respect of the following assets: (1) the acquisition and disposition of securities in companies, whether listed or not; (2) real estate, land and buildings; (3) businesses.

Furthermore, the suggestion is that for the present we restrict it to that, and in that way avoid problems of roll-over, individual homes, farms, objets d'art, and all the complications that would result from valuation and scurrying around to get valuations from appraisers and all that sort of thing.

Some taxpayers and senators take the position that that would simplify the structure for the present and would subject the capital gains tax in practice to a realistic test. Have you any views on that?

Mr. Maltby: I can see the grounds for the suggestion. Some of the assets, if not all of them that you mentioned, strike me as being something that are business or trading, that is carried on.

Senator Phillips (Rigaud): We are assuming that if it is a venture in the nature of a trade, if you sell a business and the problem of inventory involves a trading profit, that is an entirely different matter. Taking the position that we are dealing with a capital asset subject to a capital gain, we move on from there on the point that I made.

Mr. Maltby: I can see it as relieving many of the difficulties.

Senator Phillips (Rigaud): What was that remark? I missed it.

Mr. Maltby: I see the restriction as relieving some of the adverse effects of the proposed capital gains tax.

Senator Phillips (Rigaud): Do you think that by eliminating some of the items, merely by including the

ones that we have mentioned, that we would be excessively discriminatory in favour of people who may want to buy paintings or objects d'art or play around with the odd acquisition? Do you think that is a relevant or important factor in the introduction of a capital gains tax and the revenue to be expected?

Mr. Maltby: I am really not close enough to this to answer with experience on it. There is discrimination, of course. That is the point of the proposal.

Senator Phillips (Rigaud): But it could be tested out and we could see whether a mistake was made by their elimination?

Mr. Maltby: Yes.

Mr. Clennett: On this same question, I think we would support the senator's suggestion that this is substantially in line with our thinking in this area. We are concerned about the problems of introducing this kind of legislation that the White Paper proposes. The senator's suggestion would certainly go a long way to relieving some of our concern in this area, that you would not be concerned with things which are covered in our brief here, such as problems of houses and whether you have a \$500 limit, and so on.

I can appreciate the point the senator makes, that we would also gain experience as a country with this kind of legislation and, if a need for including other kinds of assets developed, the Government would not be slow to introduce the necessary legislation.

Senator Phillips (Rigaud): That is all I have to say.

The Chairman: What would you have to say to a rate of 25 per cent?

Mr. Clennett: This would be—to use a good expression of our General Manager—competitive. Our view again is, and it is covered in our brief, that the rates must be comparable with those currently prevailing in the larger economic world in which we as a country operate, primarily the United States and the United Kingdom, and particularly in the United States which is so close to us.

The Chairman: Would you maintain the distinction they have in the United States on a time basis in relation to the transaction which I call the “fast buck”—that is if you buy and sell within a period of six months, that the proceeds should go into income, whereas if you hold for a year or more, it becomes a capital gain and is subject to capital gains tax.

Mr. Clennett: Well, again, without trying to define a term of six months, this seems to be a reasonable approach.

The Chairman: You see, you may, by making a time period the only distinction, throw overboard all the jurisprudence you now have on what is a capital gain and what is income. The tendency in the courts has been to classify more and more of this as income. If you are looking for something that is simple and something that will not promote litigation—although the interests of lawyers are not against having litigation—it would be a very simple way of identifying what is subject to capital gains tax and what is not. You simply look at the date of acquisition and the date of sale.

Mr. Clennett: Some of us have experience with this kind of legislation in the United States through our operations there, and, speaking for ourselves, we have not found it a problem to live with.

The Chairman: You mean just with this time basis for identification of a capital gain. Any other questions on the capital gains aspect?

I notice in your brief you have made some reference to estate tax in relation to capital gains. Do you want to deal further with this?

Mr. Clennett: This is mentioned in our brief as something which we feel requires study by all the appropriate authorities. Estate tax and succession duty is a provincial matter, and certainly in some respects it has been suggested that some of the existing federal estate taxes are a means of collecting income tax which was deferred for the time being on things like pensions. If that is still the approach of the authorities, then, if we are having a capital gains tax, I think whoever is drafting the legislation should endeavour to get all the parties concerned, including the provincial governments, to agree on the approach and ensure that the combined system is completely equitable. We did not have any particular suggestions other than to draw attention to the need.

The Chairman: Well, I had one I wished to make, but before doing so, there is a comment I would like to make. I would think the area of agreement as between the provinces and the federal authority in determining what kind of a tax law we are going to have is much broader than simply in relation to estates.

Mr. Clennett: I would agree.

The Chairman: And I think you will agree too that the problem cannot be really solved until that broader area of agreement is reached. Now the question I wanted to put to you is this; the White Paper says that if a man dies and he has left some shares, for instance, or securities to a beneficiary, the estate tax will apply to the transaction, unless it happens to be his widow, but so far as capital gains are concerned the transaction will not be looked upon as taxable if the then value is greater than the cost to the deceased, but that capital gains imposition would be deferred until that beneficiary disposed of the asset he had received. It appears to me that that does not quite deal with the situation because the estate may have to dispose of some of these things, in which event the capital gain would fall in right away, and possibly in those circumstances the capital gain should be a credit against the estate tax. What would you think of that?

Mr. Clennett: We had not considered this particular question.

Senator Phillips (Rigaud): Don't make your answer too clear; leave room for the tax lawyers.

Mr. Clennett: I was going to wonder if I had understood the question correctly. It is the suggestion that the capital gain on the disposal, which is presumably camouflage is to be used to reduce the tax which is payable?

The Chairman: The estate tax, yes.

Mr. Clennett: Or a capital gains tax.

The Chairman: Yes.

Mr. Clennett: I am sorry, I did not hear the word "tax".

The Chairman: It is a big word.

Mr. Clennett: It would certainly seem that something in this direction would be necessary. This is the type of problem we considered when we raised this question here, and not that we thought we had the answers—we are not specialists in this area—but we do see the problems of our clients, and we felt we should draw attention to this.

Senator Isnor: Mr. Chairman, are the Bankers' Association definitely opposed to capital gains on principal residences?

Mr. Clennett: That is correct.

Senator Isnor: I think you should state that for the record.

The Chairman: It is in the brief.

There has been a suggestion, Mr. Leclerc, that the sale of a farm, so long as the farm continues in use as a farm, should also be exempt from capital gains tax. Have you any comment on that?

Mr. Leclerc: You mean what would be the difference between a farm that is owned by a farmer and a person's residence? If I change my residence for my personal use and it would be taxable, what would be the use in not taxing a farm if it is sold; is that it?

The Chairman: No. The White Paper proposes to tax a principal residence in capital gain. I understood your official view to be that you would not favour the taxation of a principal residence?

Mr. Leclerc: Yes, that is right.

The Chairman: What I am saying is, so far as farms are concerned, if the farmer sells his farm there are so many problems as to value because there is a very limited market so long as the farm is being sold as a farm. I would take it, for instance, that farms at this time in the West would be much more difficult to sell and would command much less in the way of price than they would have a few years ago. Would you subscribe to the view that a farmer in selling his farm, and the use as a farm continues, that the gain on that transaction, if any, should not be subject to capital gains tax?

Mr. Leclerc: I would subscribe to that myself.

The Chairman: We do not need to waste time on the deems of the realization, the five-year re-evaluation. Everybody who has come here has spoken against it, including even some members of the Committee. If you have anything further that you want to add, you may.

Senator Willis: I suppose they ought to be warned that if they are in favour of it their views are expressed at their own peril.

The Chairman: I was going to make use of the expression "I dare you to say anything more." Now I think we have dealt with the capital gains question as far as we want to go with it. I would like to have your comment on the treatment of foreign source income under the White Paper.

Mr. McKie: Have you any specific questions, senator?

The Chairman: Not to start off with unless you want us to do that.

Mr. McKie: We take a pretty jaundiced view on the foreign source income. As the senators appreciate, the chartered banks mainly operate branches abroad which means that we are currently taxable in Canada on these profits whether or not they are remitted to Canada. That is the way it is at the moment. If we bring back profits from bona fide operations in countries like the Bahamas or the Cayman Islands Canada reaps the benefit of the tax exemption by people operating in these tax-free countries. At the same time, of course, we operate in countries which have higher taxes than Canada and there seems to be something unfair about not being able to offset some of these profits which have not suffered a foreign tax against the tax we suffer, the very high tax. This is kind of a jaundiced view.

The Chairman: In other words, a system of tax credits where you could have a buildup of foreign tax credits?

Mr. McKie: Or an averaging.

Senator Phillips (Rigaud): Eliminating the integration, on the basis of the present law, as I read your submission, the only item that seems to be bothering you is the non-deductibility of charitable donations in foreign jurisdictions. That is all I seem to extract from the criticism of the present set-up; or is there anything more I have overlooked in the brief?

Mr. McKie: That is an unfortunate one. I think our main difficulty in the international field is withholding tax. That is withholding tax on commercial interests. If we make loans abroad and suffer withholding tax we cannot get full credit. It seems to me this is a flaw in our foreign tax credit provisions and in our treaties which could be amended to the benefit of our borrowers. I would suggest that the banks do not ordinarily make loans on which they don't expect to make a profit so obviously if withholding tax is an added cost to the bank then the borrower is going to pay that added cost. This is a very important aspect of our brief, I would suggest.

Mr. Clennett: I would agree with my colleague. In answer to the latter question and the earlier question, one of our problems which we find in the existing

legislation is the limitation of tax credit because of a country-by-country requirement rather than an averaging. This field could be improved. Also upon occasions and not infrequently it places us in an unfavourable competitive position with banks from other countries which operate under a different regime. This, of course, loses the business for a Canadian bank.

We have similar problems with the treatment of commercial interest. To a bank interest is our stock-in-trade, our money. The cost is the same as the plant or wages to a business. We certainly find it restrictive and impeding our activities. With our treaties and legislation we don't often get a full tax credit on withholding tax on interest. This, of course, leads us to have to pass up business, particularly when you combine it with the earlier feature that we cannot average.

Senator Phillips (Rigaud): May I put a question under this heading but not relative to the last point? It has been suggested that if we eliminated the withholding tax on interest paid to non-residents from the Canadian standpoint that would bring in a considerable amount of capital into Canada, particularly from the United States, that is not now taxed, and it would help the Canadian economy because the foreign investor would be investing in funded debt rather than in equity, and in the process help us in our proposed orientation of Canadian participation in equity development.

Has the banking system any view on that question? Would it support that line of reasoning: rather than withholding tax if this form of revenue were removed that there would be a substantial inflow of capital in excess of what we are now getting.

Mr. Finlayson: I would say we would agree.

Mr. McKie: There is evidence of it particularly from investors who do not pay tax in their own countries. It became available to trade unions, for example, in the United States, and we noticed a great deal of investment coming along with the exemption certificates. I think that underlines the validity of your point. Undoubtedly when there are countries which themselves impose no tax then Canada would be attractive to them if there were no withholding tax on the interest.

Senator Phillips (Rigaud): On the overall balance of payments benefit that would result therefrom do you

think it is advantageous to the economy of our country if we introduced that concession?

Mr. D. D. Peters, the Canadian Bankers' Association (The Toronto Dominion Bank): It depends on your outlook for the balance of payments. In the past two or three years we have reached a rough balance of current account which would mean we do not really require a major capital import to balance our current account. We need capital imports to turn over the material obligations and with the recent moves to the floating rate there are again questions as to what the long run development in our balance of payments would be. If it is policy to develop a balanced current account then I don't think it would be necessarily in the country's interest to eliminate this tax.

Senator Phillips (Rigaud): What about it in terms of the other point that was discussed: tending to shift foreign investment from equity to funded debt?

Mr. Peters: It would tend to make the relative advantage.

Senator Phillips (Rigaud): Do you think it would be dangerous to our economy to do that?

Mr. Peters: I don't think you would shift a major proportion of the foreign investment in Canada by that particular method. The major investment is not in equity investment; it is in shares that are tradeable and marketable in the way that they can be substituted for debt. The major investment is direct investment in plant and machinery and wholly-owned subsidiaries and developments of that nature. I don't think that particular item would have that particular development.

Senator Phillips (Rigaud): Specifically, would you be in favour of such exemption as a banker? I am directing myself to you as an individual.

Mr. Finlayson: There would be a difference of opinion perhaps amongst individual banks, senator. I personally would be in favour of it if we could make it more competitive as to the yield on investment in form of debt. I think it would be desirable.

Senator Phillips (Rigaud): We have a body here that is responsible to the economic lifeblood activities of our country. I would like to ask them a question. The suggestion has been made that we might exempt from income the yield on municipal and provincial bonds up to a ceiling, whether it be a thousand dollars or two

thousand dollars or fifteen hundred dollars, and in that way assist the municipalities and the provincial authorities in having access to funds. What would be the reaction of the banking system to that?

Mr. Leclerc: Up to a certain amount?

Senator Phillips (Rigaud): A thousand dollars on a municipal and fifteen hundred dollars or a thousand dollars on a provincial bond.

Mr. Leclerc: It would be the small investors who would profit; not the big ones. It would not matter to us in our portfolio.

Senator Phillips (Rigaud): Do you think it would open up the market to the municipal and provincial authorities to get funds that are now blocked to them?

Mr. Leclerc: I would say it would, yes. I don't know what the feeling of the other banks would be.

Mr. Finlayson: I don't know that the industry has a point of view on that. Certainly anything that would help the municipalities in periods of scarce money would be desirable. I don't know if it would clutter up the investment picture having special arrangements for the municipalities only on this.

The Chairman: In a lot of States in the United States, maybe all the States in the United States, they have tax-exempt issues.

Senator Phillips (Rigaud): Mr. Chairman, I think the other items in the submission are those we have dealt with pretty well but before we leave our bankers I would like to put another question to them.

It is not known perhaps to most of you gentlemen that our Chairman is quite a Shakespearean scholar. I find that this brief is sort of a "Hamlet" without the ghost. You don't deal with the extractive industries at all. There is the whole question of depletion tax holidays and that sort of thing. Is that done by design in order not be subject to the resentment of your clients or did you decide to leave it alone?

Mr. McKie: I think it was right, in answer to your question.

Senator Phillips (Rigaud): You think they may as well come forward themselves.

The Chairman: Very quickly we will be hearing from the Mining Association. We have heard from many elements in the extractive industry so we have a pretty good idea on that subject.

Are there any other points, Mr. Leclerc, that you would care to deal with specifically?

Mr. Leclerc: No, I have nothing to add to our brief.

The Chairman: I am a little concerned. You support the theory of nothings. That is the treatment of goodwill in the White Paper. We have had some suggestions that it is so complicated that the best way of dealing with it would be to forget it; or if you are going to do something about it, treat it as land.

Mr. Leclerc: I would not say that because something is very complicated is a reason to drop it. You should study it very thoroughly and try to find out something about it.

The Chairman: I was not pro or con on it. We have had views expressed and I notice your view favours the proposed treatment of goodwill and you do agree that it is a complicated method which is proposed and the application of it really is retroactive to a considerable extent.

Mr. Leclerc: Yes, it is.

Senator Kinley: What about business promotion and entertainment expenses?

Mr. Finlayson: We are certainly in favour of reasonable deductions for entertainment or other expenses that are directly attributable to earning income in the corporation.

The Chairman: Yes, that is in the brief. If you have any other features you want to deal with, now is the acceptable time.

Mr. Leclerc: No, nothing else, sir.

The Chairman: Thank you very much.

Senator Molson: Mr. Chairman, I have a question I want to ask. I would like to ask the gentlemen representing the banking industry what their view would be about the application of the proposals of the White Paper with regard to the ease of administration on the part of the Department, on the part of business, and on the part of the individual, to make

the necessary returns that would be required if the White Paper were implemented.

Mr. Clennett: I think we mention this at several points in our brief: the great administrative difficulty and the administrative problems which would be posed if the White Paper were to be enacted into legislation. It would create problems for ourselves as banks and it would create problems for individuals and for corporations.

Mr. McKie: Also, senator, in the former U.K. system of integration there was not a self-assessment system, as we know it. We virtually assess ourselves when we file tax returns. Under the former U.K. system that was not the case. The Inland Revenue Department made the assessment. They were the people who computed the tax liability and the individual filed returns and the corporation filed returns. Basically the Department computed the tax liability which means an acknowledgement of a complicated system.

We do feel a good many of the White Paper proposals would create enormous complications for taxpayers, business, and for the Department of National Revenue.

Senator Molson: Do you think it possible by any stretch of the imagination that the regulations required would be so complicated that the system itself would fall down?

Mr. McKie: I hope it would not fall down but it would be very difficult. The United States regulations occupy two volumes at the moment.

Mr. Finlayson: It is a possibility I would think, senator; it would be so complicated, so onerous.

The Chairman: If they did not fall down completely it would bring about such delay it would really mess up the whole system.

Mr. Clennett: We would also believe that in the early stages it would create inequities because of the difficulty of guarding against all the loopholes, the type of which concern the government at the present time.

Senator Molson: One witness yesterday or the day before pointed out that in closing the loopholes in the White Paper a whole new set of loopholes would be created and therefore a whole new method of approach would be created to the problem of tax returns.

Mr. Clennett: We would agree.

The Chairman: Even the White Paper in some of its proposals admitted that loopholes resulted and then proceeded to attempt to close those. No matter what gets into the law there are bound to be loopholes unless you say, "thou shalt not do this," and apparently that is not even immune.

Senator Carter: Before the bankers leave us, there is a little bit of information I would like. Coming back to small business, more specifically to the Small Business Loans Act, I wonder if from our witnesses we could get some indication of the percentage of loans made under the Small Loans Act which would be made anyway if the legislation did not exist. From the cases that have come to my attention I would say the percentage would be fairly high.

Mr. Finlayson: I don't think, senator, that we have statistics to answer the question. I would perhaps think the point is valid: some of the loans that would be taken under normal banking arrangements might otherwise be in the Small Business Act.

As I mentioned earlier from my own experience, and I have not been directly involved for some time, the volume has not been that heavy. This bears out your point, I think.

The Chairman: Thank you very much.

The Chairman: Honourable senators, we will proceed next to the submission from the Board of Trade and Metropolitan Toronto. We will have an opening statement by Mr. Kerr and then he will introduce the panel.

Mr. J. W. Kerr, (Chairman and Chief Executive Officer, Trans-Canada Pipe Lines Limited), President, Board of Trade of Metropolitan Toronto: Thank you, Mr. Chairman. Honourable senators, please accept our sincere thanks for this opportunity to appear before you to speak to our brief on the White Paper proposals for tax reform.

These proposals have great significance for the business community. The Board of Trade of Metropolitan Toronto has a membership of more than fifteen thousand and represents a very wide variety of small, medium and large business enterprises and services. We do represent a great many small business operations. We feel it is our duty to express our views

on this White Paper to you as members of the Senate. I think also it is factual to say our views represent a major cross-section of the business community of Metropolitan Toronto.

The approach and the procedure that we have followed during our analysis of these proposals is described in the preface of our brief.

In our membership we are fortunate to have considerable tax talent and business knowledge and we believe that our brief reflects this practical experience. We trust you find our approach is objective and constructive and helpful to your efforts.

The members of the delegation of the Metropolitan Toronto Board of Trade are first, on my immediate right, Professor S. Friedland, Economic Advisor to the Board of Trade Taxation Committee and Director of Capital Markets Research, York University. On his right, Mr. J. K. Gibson, F.C.A., Member of the Board of Trade Council and Past Chairman and member of the Board of Trade Taxation Committee. Senior partner of Clarkson, Gordon and Company.

On Mr. Gibson's right, Mr. S. E. Edwards, Q.C., member of Board of Trade Taxation Committee. A partner in the Fraser and Beatty law firm. On Mr. Edwards' right, Mr. R. M. Wingfield, C.A., member of Board of Trade Taxation Committee. Associate of Arthur Andersen and Company.

Then Mr. D. S. Anderson, the new President of the Board of Trade of Metropolitan Toronto and Director and Senior Vice-President, Royal Bank of Canada. Mr. P. T. Clark, F.C.A., Chairman, Board of Trade Taxation Committee and former Comptroller of Revenue for Ontario-1948-1963. Now in private practice as a Tax Consultant.

Mr. Chairman, our four principal witnesses are Professor Friedland, Mr. Gibson, Mr. Edwards, and Mr. Wingfield. They are going to give a brief résumé of their particular area of participation in our submission to you. First, Professor Friedland, please.

Professor S. Friedland, (Director of Capital Markets Research, York University), Economic Advisor to Taxation Committee, Board of Trade of Metropolitan Toronto: In the economic analysis of the White Paper we took the position of analyzing the external effects as it affects other than revenue-raising of the proposals. Clearly there has to be trade-offs among the various conflicting goals of the economy. In this case it seems to us to be a trade-off between equity and growth and after going through it we are not sure

whether it is a trade-off or a sell-out. We do disagree with the White Paper conclusion that there will be relatively little impact on growth. Specifically with the change in personal rates, which otherwise may be quite meritorious, we do have a redistribution of income to lower income groups where studies throughout the world and historically have shown that savings are smaller for lower income groups than higher income groups and so we do anticipate some reduction in the overall savings rate because of this.

Then the treatment of widely-held companies where there is now taxation based on capital gains and 50 per cent flow-through puts the premium now on dividends relative to capital gains which would favour stable established companies versus high-growth companies.

When we turn to closely-held companies the problem is even worse because here we have 100 per cent flow-through proposed for dividends and 100 per cent tax on capital gains and these are precisely the companies which most need internal funds. Looking at other dead instruments, returns on non-equity instruments, the required returns would be even higher because they are given no flow-through provision and subject to taxation on the full capital gain.

The authors of the White Paper apparently expect that there will be institutional repatriation of funds from abroad because of the 10 per cent asset rule and because of the flow-through provisions. We think this is quite unlikely. There will not be enough repatriated to offset the decline in domestic savings.

Unfortunately, as you go through the White Paper all of the factors are anti-growth; none are pro-growth. Whether or not they fulfil some narrow definition of equity or not seems to us almost beside the point because there is no bargain struck here.

Mr. Kerr: Thank you, Dr. Friedland. Now Mr. Gibson.

The Chairman: Before you move on, the White Paper reports that the additional tax revenues resulting from the elimination of the lower rate of corporate tax in small business would produce in the area of 400 million dollars of income in the fifth year. How do you regard that in the context of economic growth and savings and investment that Canada needs so badly?

Professor Friedland: I gather you would like it addressed to at least the statistical estimate itself?

The Chairman: Yes.

Professor Friedland: The statistical estimate, so far as we could determine it, was based on a model developed in 1962 or 1963 and applied to 1968 income. It has underneath it the assumption that people will allocate their funds exactly the same way, regardless of the tax system. This is a proposition that is somewhat incredible and flies in the face of the facts of which we are aware. If growth is reduced the revenue coming to government will be considerably smaller, and not just from small business.

The Chairman: No. I am thinking of that sector of small business, and if you take out of it and put into the public treasury in the fifth year over 400 million dollars that represents savings in the form of retained earnings gone to support the operation of expansion of business. Would you regard that as being an important element in stifling economic growth?

Professor Friedland: It certainly would be in the new and small firm, very, very damaging, a transfer of funds.

Mr. Kerr: Mr. Gibson, please.

Mr. J. K. Gibson, (Partner of Clarkson, Gordon & Company): Member of Council, Board of Trade and Metropolitan Toronto: Dealing first specifically with the tax reform procedure that we are faced with, the Board feels that the White Paper has in fact attempted to achieve too much in one major surge of effort. The attempt to deal with everything at once has meant that satisfactory alternatives to many of the complex proposals are not likely to be adequately considered. They cannot be fully developed or adequately considered in the time available to us, particularly in the context of their relationship with other proposals with which they belong.

We suggest that the reform proposals should be considered and implemented in three stages; dealing first with the changes most urgently required and leaving the more controversial proposals for more careful consideration.

The Chairman: You have given two classifications. Would you care to make an allocation?

Mr. Gibson: This is a somewhat difficult thing to do, Mr. Chairman, but we have suggested in the first instance under stage 1 that urgently required changes that could be accommodated at the present time should be made and should not wait until the more complex proposals would be developed.

That might include, for example, some improvement in the rate of personal exemption structure. This is obviously long overdue and it is a question of how much can be afforded without other major reforms.

In the second stage we suggested that a capital gains tax might be developed that would be satisfactory in form and possibly if work were proceeded on this that could be accomplished by the end of next year. We had in mind a somewhat different form of capital gains tax than the one proposed in the White Paper. Obviously this would require quite a bit of additional work in developing a satisfactory proposal that would fit with the basic context of the present system.

Following that stage, which would presumably include some further modifications in the rate structure to improve the equitable aspects of the system, the more complex and controversial proposals, such as the integration proposal and the proposals affecting international operations, could be looked at a good deal more carefully in relation to the system which has been already modified to a considerable degree, having adopted the proposals that are really fundamental to the government objectives. Some of these more complex proposals, such as integration, would be looked at in a more rational way.

The Chairman: If it were not for the fact the White Paper was coming up many of the proposals in the White Paper would ordinarily have been dealt with in natural amendments to the Income Tax Act. Is that not correct?

Mr. Gibson: I think a good deal of them would. Certainly the White Paper proposes much more fundamental proposals than one would want to see on an annual basis.

The Chairman: You wonder sometimes. There was a major change in taxation last year when they reached out and gathered in the insurance companies. That was a major change. At least the insurance companies thought it was.

Mr. Gibson: I would agree with that.

The Chairman: Go ahead, Mr. Gibson.

Mr. Gibson: The other aspect deals with the proposals the Board has made relating to individuals and families. We support proposals for increased personal exemptions, which we feel are long overdue. We also feel some increased assistance should be made to older retired persons. We agree in principle with the

proposed childcare and unemployment allowances although we have some reservations about the requirement in the White Paper proposals on claims for child care relief which should be required to be proved. I think this has administrative problems which may be unnecessary.

We feel that the proposed reduction in the top rate of tax should be implemented at the outset rather than phased in and more satisfactory income averaging provision should be developed.

Mr. Kerr: Thank you. The next speaker is Mr. S. E. Edwards, Q.C.

Mr. S. E. Edwards, (Partner in Fraser & Beatty Law firm), Member of Taxation Committee, Board of Trade of Metropolitan Toronto: I will summarize the principal proposals in the areas of capital gains and corporations and shareholders. In the area of capital gains the Board proposes that one-half of capital gains should be taxable and the maximum rate of 25 per cent applied to such gains. We also propose that the valuation day procedure should be substantially altered and designed to gauge the transition to get away from the huge number of valuations which would be necessary under the present proposal and have some type of proration procedure such as recommended in the Carter report.

We propose that the five-year revaluation proposal be eliminated and that the provision for deemed realization on leaving Canada, which we regard as a White Paper wall around Canada, should be either eliminated or at least the tax should be deferred until actual realization with security put up in the meantime.

Five-year evaluation gains should be deemed to be realized at the time of death but this only if the estimate tax is very substantially reduced and the capital gains tax integrated with the estate tax. We have suggested, without being too specific, a maximum estate tax rate of 15 per cent with deduction of the capital gains tax in computing the value of the estate.

In connection with corporations and their shareholders, and first of all with respect to small business, the Board believes that such business needs assistance and that the assistance or incentive should be designed so it won't help big business. Our proposal is that the amount which is subject to the low rate should reduce as income increases so that with each two dollars of income of the company in excess of \$35,000 the amount subject to the low rate of tax would decrease

by a dollar so when you reach \$105,000 taxable income the entire income would be taxable at the full 50 per cent rate.

We would eliminate the distinction between closely and widely-held companies but at the same time broaden and liberalize the partnership option.

We suggest two alternatives with respect to integration which are similar in principle. One would be to retain the present dividend tax credit but increase it from twenty to twenty-five per cent. The second alternative would be to have a gross-up of 50 per cent, similar to that provided in the White Paper for widely-held companies, but give credit for the 50 per cent tax grossed up but make the credit unrelated to the tax actually paid by the company and the credit non-refundable. We think one of these alternatives is necessary to make the system simple and workable.

We suggest that inter-company distribution should be tax-free. We believe that this system recognizes the factor of inflation to some extent and it would improve the incentive aspect of the legislation and make a simple and relatively workable system.

Mr. Kerr: Thank you, Mr. Edwards. Now our other principal witness, Mr. R. M. Wingfield, on Business and Property Income and International Income.

Mr. R. M. Wingfield, (Associate of Arthur Anderson and Company), Member of Taxation Committee, Board of Trade of Metropolitan Toronto: Mr. Chairman, in Business and Property Income we first looked at goodwill and found this is not like other assets. It does not have a fixed value; it has a variable value from minute to minute. It cannot be amortized or depreciated and in fact informed accounting opinion seems to point this way also. Therefore we believe it should not be depreciated. Then in the transitional provisions for goodwill at the start of the system we believe it should be valued at only the increase in tax. Certainly the sale proceeds must not be taxed by reference only to the proceeds. There must be full recognition of purchased good will and the free system of good will.

Under Business Expenses we believe existing provisions in the Income Tax Act deal adequately with entertainment and convention expenses. Nothing must be done to curtail educational conventions and entertainment directed at increasing income. Existing regulations already prohibit social and personal expenses.

As to property income, the loss on holding of property caused by capital cost allowance, real estate taxes and mortgage interest, should be allowable against other income. There can be no doubt about this when loss is incurred in the course of business. This can be expended. If all income is to be taxed then all related expenses should be deductible.

In the international area dealing first with debt capital there is serious additional cost of borrowing large sums for large projects due to the 15 per cent withholding tax. This puts us at a competitive disadvantage. We need to borrow from foreign lenders. We are one of the few countries whose treaties do not give complete exemption for the 15 per cent withholding tax on interest.

As to equity capital, the combination of the high corporate tax rate and the 15 per cent withholding tax on dividends also restricts direct investment from abroad. We believe that the treaty rate should ensure this combination does not exceed the greater of the Canadian corporate rate or the foreign corporate rate.

In the area of exports in the less-developed countries we wish to see every incentive possible for Canadian business to extend its domestic manufacturing volume by exporting abroad. The proposal to tax the foreign sales operations in Canada may well prevent our exporters from competing. Nor would we want Canada to prevent its business from aiding the less-developed countries. This might well happen if we tax away in Canada the tax inducements given by those countries. Thank you.

Mr. Kerr: Thank you very much for this opportunity of allowing our principal witnesses to talk about their areas of participation.

Before we proceed to the questions I would like to introduce Mr. J. W. Wakelin, General Manager of the Board of Trade, and Mr. T. G. O'Connor, the Legal Secretary.

The Chairman: Mr. Gibson, you included some reference in your statement to averaging in the White Paper. Is that right?

Mr. Gibson: Yes, sir.

The Chairman: We have learned from many witnesses who have been before us in relation to profit-sharing plans and retirement saving plans that averaging would increase the tax of the lump-sum payments which the workman would get when he reaches retirement. It would appear in some cases to

be almost 100 per cent. In other words, there would be a doubling of the tax.

Mr. Gibson: The way we understand it, sir, the averaging provisions would not be much more onerous or much more beneficial than the present averaging rules provided in the Income Tax Act now.

The Chairman: In addition to which the new rules appear to be very complicated; do you agree with that?

Mr. Gibson: I do, sir.

The Chairman: Have you been able to interpret what the threshold provision means?

Mr. Gibson: I am not certain that I understand it. I think there is no doubt it is a complex thing and one which would be difficult for the average taxpayer to deal with; so much so that the White Paper suggests that this would have to be done for the taxpayer by the tax department. That does not seem to be an entirely satisfactory provision.

The Chairman: No. What is the position of the Board in relation to Section 36 as against what the White Paper has to say about lump-sum payments?

Mr. Gibson: We regard the averaging provisions proposed in the White Paper as quite inadequate in comparison to the present averaging provisions which are considerably better. As a matter of fact, one aspect of it is, this will really affect more than anyone else the middle and lower-income groups who would require averaging. At the upper income levels averaging under the proposals would not really be required as the top rate of tax is reduced to something in the order of 50 per cent.

The Chairman: Does it appear to you to be unfair that the contributions which have not been subject to tax by these taxpayers over the course of a lifetime, and which have been made in periods when the rates were much lower, assuming they have been subject to tax. Now when they come out they come out at this top rate which increases very substantially the tax burden at a time when the man is on the verge of retirement but is still in the high tax bracket.

Mr. Gibson: This really represents in many cases his main source of livelihood for the future.

The Chairman: That is right.

Mr. Gibson: I don't think we considered this particular point in our discussions but I think we agree with it.

The Chairman: If people are encouraged by various means to provide for their retirement and some benefits are given to them to do that then for a lot of these people who will become entitled to lump-sum payments in the next two, three, four or five years are in for a very considerable shock and a substantial lessening of income available to them to live on.

Mr. Gibson: And much less favourable treatment than they had every reason to expect when they made the contributions.

The Chairman: And yet the White Paper speaks about equity and fairness and making ability to pay the test. There does seem to be some contradiction, doesn't there?

Mr. Gibson: Yes, I believe so.

Senator Phillips (Rigaud): Mr. Chairman, in view of the fact that the White Paper is not unrelated to the Carter report I was wondering whether this Committee, coming from Toronto, has a letter of apology that should be inserted in the record; being partially responsible for the White Paper we are considering. I am assuming you have not got that so I will go on the record with my question.

I would like to direct myself to Mr. Edwards in connection with the capital gain. You gentlemen are supporting the integration, if we could use that word, of capital gains if, as and when introduced, with the estate tax because obviously if you get the cumulative effect of both we end up with confiscation rather than taxation.

In view of the fact that the provinces, particularly the Province of Quebec and some others, take a strong position that estate taxes should ultimately fall under the jurisdiction of the provinces, don't you think it would be desirable to suggest that if we were to have a capital gains tax it should be accompanied by an agreement between the federal government and the provinces that there will be no estate taxes exigible in Canada.

The reason I say that is because sooner or later you are going to get a shifting-back of the estate taxes to the provinces and it is going to be administratively very difficult to work out an integration between a capital gains tax and an estate tax. It would appear to

me to be common sense if we are trying to work out a proper system of taxation and that with capital gains here to stay the federal government should agree to subsidize the provincial governments in the return for the elimination of the application to estate taxes because of the revenues that will be coming from capital gains. In that way the taxpayer will have reasonable assurance we are not going to get it both ways.

This is the first time, gentlemen, that I have raised that issue.

Mr. Edwards: I would agree with that, Mr. Chairman. I think our proposal is made entirely on the condition that the estate taxes should be reduced substantially. We didn't suggest their elimination but we suggested they be reduced to a modest rate. That would not have any validity if the provinces were to continue imposing succession duties.

Senator Phillips (Rigaud): Yes. I draw your attention to the fact we dealt with previously, that the introduction of the White Paper plan was conditional on the consent of the provinces and we know how far we are getting that consent.

We are assuming the elimination of the integration system under the White Paper. We are also assuming, as the Chairman pointed out, that the climate is such we are going to have most likely a capital gains tax. We are doing a lot of talking about integrating capital gains or correlating with the estate tax.

In Winnipeg last week the Quebec provincial government took the position that estate taxes should be handled by the provinces. Obviously if Quebec were to insist on the retention of that position the other provinces instead of farming it out federally would probably want to get it back. Practically, there would be no protection in dealing with capital gains tax and tying it in with an estate system unless we abandoned the estate system and say to the federal authorities, "Get your income under capital gains and earmark it for the provinces in return for the latter abandoning the estate taxes." Otherwise you will never get correlation of integration.

Mr. Edwards: I agree, Mr. Chairman. That relates not only to this field but the whole tax system. It has to be closely integrated with the tax systems of the provinces, otherwise there is no possibility of any real equity throughout the country on the tax system.

I think I have already agreed that it would be desirable in order to achieve that to have the provinces

agree not to impose succession duties and to leave that in the field of the federal government where it would be possible to integrate the capital gains tax with the estate tax.

Senator Phillips (Rigaud): This is the first time we have dealt with it in committee. Maybe there is something to the point that we should have a capital gains tax earmarked as a so-called trust account in the federal government, a segregated fund, so we get an ultimate relationship between the subject matter to which we have referred. Otherwise I think we are living in an Alice in Wonderland talking about integration in the federal system which won't take place unless the fundamental point is cleared up between the federal government and the provinces.

Do you agree with that?

Mr. Edwards: Yes.

Senator Carter: Do you mean a trust fund would be for the provinces?

Senator Phillips (Rigaud): It would be agency monies held by the federal government for the provinces.

The Chairman: They simply earmark an amount of money in the consolidated revenue fund and then you don't need annual legislation of any kind. It is just paid out.

Senator Phillips (Rigaud): That is correct, in that way you could have some agreement with the provinces to give up estate taxes.

The Chairman: When we were dealing with the Estate Tax Bill I think we had evidence to show that 90 per cent of the take under the estate tax that was paid over by the federal authority to the provinces. I think that was the figure.

Mr. Edwards: I thought it was 75 per cent.

Mr. P. T. Clark, (Tax Consultant), Chairman of Taxation Committee, Board of Trade of Metropolitan Toronto: From what I have read recently it appeared to me that Ontario is in favour of abolishing the succession duties in favour of a share of the capital gains tax. In my early days up there with Mr. Frost he used to talk about capital gains tax as being succession duty by instalments and it would bring the same amount of money and be far more valuable for the

economy if done that way and get rid of succession duties. I think the estate tax should be abolished if there is to be a capital gains tax.

Senator Phillips (Rigaud): I was not aware of that statement when I made this suggestion.

Senator Beaubien: Mr. Edwards, how would you treat a situation when a man died and there was a large capital loss instead of capital gain? Nobody seems to think there could be a loss but that could happen.

Mr. Edwards: Mr. Chairman, if there were a properly-designed averaging provision and assuming the man had had income in prior years, in other words if there was a five-year block averaging provision such as the Carter Commission recommended, he would be able to get refund of income tax in previous years. That would be one possible answer.

Senator Beaubien: The beneficiaries then would get a refund from the government of taxes paid in the last four years.

Mr. Edwards: Yes, by averaging the loss of the last year with the income from previous years. If it was a capital loss you would only deduct one-half of it because you would only be taxed one-half on capital gains and deduct only half on capital loss.

Senator Beaubien: If there was a large capital loss over the previous five years the estate would pay no death duties and would get a refund from the government.

Mr. Edwards: In that case, if the loss in the estate being reduced from \$300,000 to \$200,000 the estate tax would be applied only to the \$200,000. Under our proposal it would be a very modest rate, 15 per cent maximum.

Senator Beaubien: Then the beneficiaries would get something back because there had been a loss of \$100,000.

Mr. Edwards: Yes, but that would be an adjustment to the income tax. In other words, that would be part of our integration proposal.

The Chairman: Is there not a little fanciful thinking there? An estate is an estate and whatever is in it when the man dies. It is either one dollar or ten dollars or a hundred dollars, and if he has that in assets, why he is subject to estate tax. The only aspect is, if in the

estate there were shares of other securities which had decreased in value as against evaluation date he might end up with a negative estate in which event he would not be subject to estate tax. Not having anything to set off losses against how do you justify going back into previous years and claiming a refund of income tax paid? Income taxes are not necessarily related at all to the problem you consider at death.

Mr. Edwards: No. I simply suggested if there were a loss on death that were deemed to be realized on death then it would be loss to be treated as any other loss under the income and capital gains tax system. If you had a good averaging provision you would be able to average the loss with previous years.

The Chairman: You mean if you had a loss carried back, because a loss carried forward would not mean anything in those circumstances.

Mr. Edwards: That was the proposal of the Carter Commission.

Senator Phillips (Rigaud): It might be something if you believed in immortality!

Senator Beaubien: In the case where the estate taxes were abolished with the consent of the provinces and there was just a capital gains tax at death how would you treat it, then, if there was a large capital loss? There has been a suggestion that the provinces, because the federal government is going to pay them a proportion of the capital gains, as death will do away with estate taxes. If you do away with estate taxes and there is a large capital loss at death how is that treated?

The Chairman: It looks as though it would be for the account of the deceased!

Senator Phillips (Rigaud): Could we come to Professor Friedland's initial analysis of the shifting of the tax burdens to the middle-income bracket? As you come from Ontario, and Metropolitan Toronto particularly, we would like your reaction to the following: there seems to be some resistance to the suggestion that the exemptions be increased from \$1,000 to \$1,400 and \$1,400 to \$2,800 on the theory that although there would be losses to the treasury of about one billion or 1.2 billion you really whiplash the very people in the lower and middle-income bracket, the very people who we rely upon for savings and health in the expansion of our economy.

I don't think you developed that. Are you in favour of those exemptions?

Professor Friedland: Basically, of course, the Board's position is we favour the exemptions. I noted the increased exemptions and I noted as a result of the increased exemptions there would be redistribution of income, redistribution in the direction of those who were likely to save a lower proportion of their income than others and so the total savings would have gone off.

If I grasp your point, sir, it would seem to me what you are saying is exemption as opposed to a credit and that in fact those in the higher income get relatively more benefit than those in the lower incomes.

Senator Phillips (Rigaud): Assume that we recommend in this Committee that small business retain the 21 per cent rate which means withdrawal from the treasury, according to its projections, of about 400 million dollars and assuming that the exemptions would cost 1.2 billion where would that 1.2 billion come from to balance out the budget?

According to the White Paper the plan is to shift it over to the lower and middle-income bracket. To a good many of us it does not seem to make sense to grant the exemptions to other than those in the really lower bracket who need it for the purpose of getting a reasonably standard of living. A good many of us think you should not go across the board granting an exemption and frantically looking for the poor chaps in the middle and lower-income brackets who are caught by it and in respect of which we could have a brain-drain to the United States and other countries.

Professor Friedland: I think the principle you are enunciating is exactly the same principle as underlines our proposition. There are a number of ways in which the purported revolutionary tax proposal falls quite short if you are looking for equity in the sense of helping people in the lower-income groups. You are doing nothing for the really poor people who are paying no income tax. You could have negative income tax proposals, which sounds radical, not in the left-wing sense but different from what we are doing now, as a means of not only helping the poor but of redistributing income among the provinces which have economic inequities.

This was apparently never even considered by the office of the White Paper. We discussed this in the Board of Trade and we are not proposing a negative income tax but I think this is the sort of thing you are leading to. We want to help, and we should want to

help, those people with lower incomes but in fact we do it very inefficiently by using deductions rather than credits and also by ignoring the lowest strata on an income basis of our society, many of whom are concentrated in particular provinces. This is a fundamental point particularly as we try to develop a nation where there are less inequities as we move from province to province.

The Chairman: I have been asking a lot of questions and I started out with Mr. Bryce and Mr. Brown and I have been continuing ever since. Mr. Brown said if you take 750,000 people off the tax rolls the loss in tax revenue would be about \$35 million. Our study which we made indicated it was more likely to be about twenty-four or twenty-five million dollars.

Now, then, as you go up the line there is the next group who by reason of the increased exemption will be paying less tax until you get around maybe \$8,000. Then the taxes are increased substantially for the next groups up to \$24,000. Part of that increase in tax is for the purpose of taking back from the taxpayer the increased exemption which is forced upon them. I am sure if he had a choice of the lower rate and the tax exemption he would say he didn't want the increased tax exemption.

I was trying to get an assessment of what the situation would be. It would be quite easy to find twenty-five or thirty million dollars somewhere in our tax system and relieve this group. It is quite easy to figure out what you might lose in revenue in the next group to get some benefit from the exemption. You saddle the whole burden of a billion dollars on the people in the range from eight or nine thousand dollars to \$24,000 and then you take away the 21 per cent lower tax rate in the small business and the people in that small business are in those categories.

What would you think of the suggestion of lowering from 82 per cent rate to 50 per cent rate the people in the high bracket? The estimate in the White Paper is the revenue loss would be about \$40 million. I think a very rapid calculation would show that if you said from \$40,000 on all income tax would be at the rate of 55 per cent instead of 50 per cent you would recover from that 5 per cent the cost of lowering, so far as revenue is concerned.

It seems to me we have been having like blacksmiths in hammering out a tax system which is going to give increased exemption to everybody. If there were people in the lower groups to be helped, help them. We are all in favour of that. Then when you sort out

the recovery you should try and sort it out on a minimum basis.

Have you made any study of this?

Professor Friedland: On number amounts we have fooled around on what would happen if you moved up the top rate a bit. Given the current high marginal rates even a movement from the 50 per cent to 55 per cent would be substantial relief to the upper-income bracket. Revenues are very sensitive to this, in the neighbourhood of what you are talking about.

It seems to me your observation is symptomatic of the problem in the White Paper in that the people who wrote it had a hang-up on the problem of income integration double taxation. And large corporations with many stockholders. It makes no sense at all. Corporation and stockholder are two different people.

There is virtually no concern with growth effects which I think have been so important in Canada. It is quite difficult to say this provision accounted for so much growth in Canada's history but nonetheless we have enjoyed a very high growth rate and we are still an under-populated and under-developed country. It really seems that this set of proposals as they appear are quite inappropriate to the country at our level of development. That is why I say it is a sellout rather than a trade-off between equity and growth.

Senator Beaubien: I would like to make a suggestion on the question of exemptions. Our studies show that our tax rate on single taxpayers is not terribly out of line with the American. Our tax rates on married people are very much higher and can go up to something like 90 per cent around \$21,000. Supposing we were to consider the impact of raising the exemption on the married but not on the single and if we take into consideration that for every married taxpayer there are two single taxpayers in Canada, the impact might not cost the treasury such an awful lot. The single people are taxed at a rate which is not terribly out of line with the American rate.

The Chairman: Do you think it might encourage matrimony?

Professor Friedland: I could make a personal comment. As someone who has been in Canada for only three years and married for 18 years I can say that the loss of the joint return that is allowed in the States came as a great blow and as a disincentive. My wife does not work outside of the house—although she points out that she works very hard inside and is

interested in getting out. We are in a position where all things considered I would be worse off if she went out to work for the kind of income she could probably make than if she stayed at home. This has a disincentive effect. We should have a good deal of concern in removing these disincentive. We are losing presumably a productive member of the labour force, at least one, and I would assume I am not unique.

Senator Beaubien: We treat the husband and wife both working comparatively well as compared to the rates in the States. It is the married man here who cannot divide his income with his wife and the rates are so much higher.

Mr. Gibson: Mr. Chairman, in the Board's brief we advocate the adoption of a joint return for husband and wife, which would be an improvement to the present system.

The Chairman: Have you been able to make any estimate of whether there would be a loss of revenue entailed, and if so how much?

Mr. Gibson: I am afraid not.

The Chairman: If you were making a guess what would you say?

Mr. Gibson: I would not imagine it would be a major loss of revenue. There would be some.

The Chairman: I think Mr. Edwards mentioned something about broadening the partnership option. If we eliminate integration in what area would you apply the partnership option?

Mr. Edwards: The White Paper contains certain fairly narrow restrictions on the election of partnership.

The Chairman: It is tied into the distinction of closely-held and widely-held companies and a part of the integration system. If we take out integration and leave the present dividend tax credit system where would there be need for the partnership option, either as described in the White Paper or as broadened by suggestions you might make?

Mr. Edwards: I suppose that if the proposal were adopted of taxing small businesses at the 21 per cent rate then the partnership option might not be elected in many cases. I suppose it is to some extent conditional on that proposal not being adopted.

The Chairman: It seems to me if you are eliminating integration and all those things and you are going to give the 21 per cent corporate rate to small businesses possibly the position you should consider is this: the unincorporated small business, so far as tax is concerned, would be subject to the marginal rate of the people who are in the business. Maybe they should be given the option for their business. They presume to be incorporated and take the 21 per cent rate. That would appear to be the direction in which maybe it should go.

Have you any comment on that?

Mr. Edwards: The Board of Trade did not consider that. I think that they have something like that in the United States. I am not very clear on just how it works down there. I think all I can say is the Board as such has not considered it and neither have I in any depth. We did recommend the partnership option should be available for companies on a broader scale so that a company would not be penalized by the fact of the incorporation over what tax would be payable by the individuals.

Mr. Wingfield: For the company I don't think there is any reason why you should not still have a partnership option because you have an additional tax. You still have a shareholder tax so there might be a tax saving by paying a low rate.

The other aspect I would like to comment on is business income as opposed to passive income. They make this distinction in the White Paper and in phasing out the low rate for small corporations they do only apply to business income. If we shift from the corporate aspect to the business aspect you can apply equally. You can use that low rate for unincorporated businesses' income for the sole proprietor or partnership.

The Chairman: Are there any other questions?

Senator Molson: I might ask the members of the Board of Trade if they have any reservation about the ease with which the application of the White Paper can be made from the point of view of government administration and the corporation taxpayer and the individual taxpayer in making their returns and complying with the regulation?

Mr. Keer: I think Mr. Gibson may have a comment on that, Senator Molson.

Mr. Gibson: Senator, we have considerable real concern over this aspect of it. Part of our problem, of

course, is the detailed provisions are not available to us, although that is understandable. One would hope that a good deal of the complication could be taken out before it is in legislative form. The introduction of the capital gains tax by itself is inevitably going to result in a very considerable increase in the complexity of our tax law. I don't think there is any question about that.

It is coupled with other very complex provisions I personally cannot see how we are going to get out of the mess for quite a while. It will be a very difficult process. First of all, there is preparing the legislation and informing the taxpayer and the public as to their obligations and devising rules that will accommodate the vast variety of circumstances which are hard to visualize at the time the law is being put out. We believe it will be a very, very difficult process. It is bad enough to tackle the introduction of the capital gains tax in a satisfactory form all by itself. We don't think it is wise to proceed with the further complication until that stage has been adequately absorbed.

Mr. Edwards: Senator, I think the paper which was brought out by the Minister of Finance with respect to integration and the related bookkeeping has given a small inkling of some of the administrative problems. I would think there would be very substantial problems making returns, particularly when there are problems as to adjusting the base for capital gains tax purposes by raising of stock dividends and many other things. The treatment of goodwill is something else again.

Apart from the actual filing of returns and the complications involved in that it seems to me that there is a real problem of legislation because drafting a tax statute is not a simple task. It seems to have been assumed by the government it could draft a statute by January, 1971, which would be satisfactory to include all these very complex changes. I think if the statute is drafted in haste it may turn into a monster through the very problems of drafting. As you start to draft you will probably find new problems and as you try to remedy them you create still more. I think that is a very strong argument in favour of the gradual approach to this reform process that Mr. Gibson has spoken about earlier.

Senator Burchill: Firstly I want to commend the Board of Trade for that suggestion of the gradual approach, their suggestion that we should try and digest this gradually instead of trying to take it all in one bite.

The Chairman: You mean digest whatever may be decided to be implemented?

Senator Burchill: I think that is a very sound suggestion.

The Chairman: Gentlemen, thank you very much. We have had some very useful ideas.

The Chairman: We have one more submission this morning, and that is the Mining Association of Canada. Gentlemen, we have the representatives of the Mining Association of Canada and the president, Mr. Kostuik, is going to make an opening statement and introduce the panel.

Mr. J. Kostuik, (President, Denison Mines Limited), President, The Mining Association of Canada: We appreciate the opportunity of appearing before this Committee to submit our views on the proposals for tax reform.

Our delegation includes Mr. Charlie Elliott, a member of the board of directors of the Mining Association of Canada and Chairman of the Association's Tax Committee. He is on my immediate right.

Mr. Bonus, managing director of the Association, on his right. Messrs. D. B. Craig, Mr. D. H. Ford and V. St. Onge, who are all specialists in mining tax matters with some of our leading member companies.

I am privileged to lead this delegation which represents the Mining Association of Canada, the recognized national organization of the metallic and non-metallic sections of the Canada mining industry, whose member companies account for more than 95 per cent of Canada's output of metals and major industrial minerals.

The Canadian mining industry's present output value is of the order of \$2.7 billion a year. The industry is therefore one of the leading economic sectors of this country.

The scope of our submission is directed to two essential and fundamental questions:

1. Would the changes proposed in the White Paper have any major impact on the long-term development of the mineral industry in Canada, and

2. If so, would this have a beneficial or detrimental effect on the Canadian economy and on regional development.

These are issues of utmost importance, and the consequences of serious misjudgment on either could be devastating. Every evidence we have been able to assemble indicates to us that the answers to these questions are yes, the White Paper proposals would

have a profound and detrimental effect on the Canadian mining industry, and yes, that effect would be most damaging to the Canadian economy and particularly to regional development.

Our brief falls into five sections and relevant appendices.

In Section I we review the contribution which the mining industry is continuing to make to the Canadian economy and regional development. We discuss the industry's growth since World War II, its outstanding performance in the field of exports and therefore its marked beneficial influence on Canada's balance of payments, its very high productivity, its exceptional "multiplier effect," and the unique contribution it makes to the development of vast areas of this country.

In Section II we dwell on the important role which the present system of tax incentives has played in the growth of the industry. We have not the slightest doubt that these provisions have very considerably encouraged mineral development across the country and that in their absence the tempo would have been very much reduced.

Section III outlines the influence which important mineral developments in other countries will have on the future of the Canadian mining industry.

We also stress here that the industry is faced with increasing costs in locating new Canadian ore reserves, most often low-grade deposits in more remote areas, and we refer to the shortfall of new discoveries in relation to the rate of development of known deposits, all of which underlines the importance of maintaining powerful and effective incentives.

In Section IV we review the result of our studies, which indicate clearly that the White Paper proposals would virtually eliminate the incentive element of the present provisions and would dramatically reduce the value of new discoveries.

We assess what effect the White Paper proposals would have on exploration, on development and on existing mining operations. We point out that the White Paper proposals would result in an increase in overall taxes to be paid by the industry of one-third to about 60 per cent. Apart from the question of equity, tax rates as high as this would clearly discourage new investment in mining.

We suggest areas where possible modifications to the present provisions might be made. However, we emphasize that the overriding principle must be to

retain effective incentive elements comparable to those in force.

In other words, the objective must be to improve the effectiveness of the incentive provisions without increasing their cost, or to reduce their cost without material loss of effectiveness. In our view, this objective can be reached without upsetting the whole of the present system, and our suggestions are based on that conviction.

Finally, in Section V, we deal with three major additional aspects of the White Paper proposals that are of special significance to the Canadian mining industry; namely, corporations and shareholders, capital gains, and international income.

We have behind us a proven record of effectiveness and resultant growth, from which substantial benefits have been derived by all sectors of the Canadian economy and individual Canadians.

As against this, we are now contending in the White Paper with a set of assumptions which appear largely speculative.

It is not re-assuring, to say the least, to contemplate how the White Paper proposals affecting mining have been put forward.

How, for instance, has the conclusion been reached that "support on a less generous scale should suffice" for the purpose of filling the need for special treatment for the mineral industry?

Then again, in discussing the economic implications of the proposals, the White Paper observes that the proposed changes would have "some effect" in reducing the expected rate of return from new mining projects. However, it goes on to state that "the overall effect on the development of new mines cannot be forecast with any certainty" and then proceeds to express unexplained confidence that the effect would not be serious!

These and other statements might be more re-assuring if there was some indication that the expressed complacency was based on a careful appraisal.

The Chairman: In other words, if they knew what they were talking about.

Mr. J. L. Bonus, Managing Director, The Mining Association of Canada: Mr. Chairman, honourable senators, I would like to touch briefly on a few additional matters which have a very direct relevance to the question of taxation of the mining industry.

These matters are not only vital to the industry but, more importantly, they are vital to Canada. However, they do tend to be overlooked, particularly when one gets deeply involved in academic and technical discussions relative to highly complex taxation theories and applications. Therefore, even before a distinguished and informed gathering such as this Committee, I suggest they might usefully be re-emphasized.

The first of these matters is very simply the world-wide importance of minerals. It is an indisputed fact that in our modern industrialized societies we could not operate without them and that, inevitably, they are becoming increasingly indispensable also the developing countries.

Without a continuing and increasing supply of minerals, or of substitute substances which ultimately may complement or replace some of them, we could not hope to maintain, let alone improve, our present standard of living.

Thus, when we are discussing any measures which would seriously affect the discovery and development of mineral resources, we should bear in mind that the outcome of those discussions will have a major influence on an essential element of our lives.

The second matter I wish to emphasize is the issue as to whether one should maximize the development of our mineral potential or conserve it. It is a philosophical issue but there is a tendency for some people to opt out for the latter course; to proclaim that we should conserve our resources for future generations rather than go all out now to develop them. Naturally, this becomes a somewhat emotional issue, particularly when it is known that large quantities of our minerals are developed with foreign capital and are subsequently exported.

Perhaps one should emphasize that mineral resources can be either "energy" resources or "non energy" resources and that the issue to "develop or conserve" might be viewed differently according to the category being discussed.

However, insofar as most conventional minerals are concerned, objective and realistic analysis does reveal very solid reasons why orderly development of minerals should prevail.

First of all, a very basic point is that minerals in the ground are useless. One often hears of them referred to as "resources" but, in fact, they only become resources when one can put a value on them and this occurs only when they are found, extracted, processed and sold.

Secondly, most minerals are needed and saleable now, and possibly may not be so in the future. This comment is in no way contrary to my initial remarks regarding the continuing importance of minerals to the industrialized world. It is made simply in recognition of the quite rapid and sustained development of substitutes.

The technology of finding and recovering conventional minerals has certainly developed well, but it has nevertheless lagged behind the technology of consumption, which has forged ahead. There is now less difference between various kinds of materials than had been supposed when they were the basis of totally separate crafts and industries, and contemporary mineral producers are aware that "properties can now be designed; not just selected."

When shortages of conventional minerals occur, these minerals rapidly come to be viewed as less unique and irreplaceable. A shortage of one, with the price increase that usually accompanies shortages, will stimulate consumers to find ways of replacing it with another commodity. As an example, one could cite what happened last year in the U.S. as a result of a shortage of copper caused by a strike. This immediately stimulated renewed interest in aluminum as a substitute in several of copper's electrical markets, and, in many cases, that interest has proved permanent. The strike-induced shortages and price rises are no doubt responsible also for the intensive development work now being performed on sodium conductors.

Beyond the competition between metals looms a greater struggle between metals and non-metallics, especially polymers. Some automobiles are already being produced with a body made entirely of fibreglass. The 1970 models of a popular sedan have appeared with a hood made of plastic bearing a sprayed-on aluminum coating. And steel gas tanks on many types of American vehicles are coming to be replaced with high-density polyethylene, which weighs far less and is easier to shape.

One lesson which can certainly be found in these examples is that mineral consumers are ready, willing and increasingly able to do without commodities to which they once considered themselves irrevocably wedded.

This poses a very real challenge for mineral producers and processors, and the primary requirements are of course not only to ensure that mineral resources are developed, but also to maintain and develop a progressive research program to ensure

continuing improvement in the efficiency of mineral exploration, production and processing operations.

A further important factor militating for early development of mineral resources is that international competition is increasing as new discoveries are made throughout the world as advances in production technology and transportation improve the competitiveness of many distant mineral sources. This is an aspect which is covered under Section III of our submission.

These are important considerations which have to be most carefully noted when discussing tax provisions which could have a very serious effect on mining. We are not dealing with an industry whose success or failure would have little or no relevance to our future. We are dealing with a major force in our economic structure, the third largest mining industry in the world, and the manner in which we direct its future will, to a large extent, determine ours.

The Chairman: Now, Mr. President, I said to you when you came up here that we were waiting for you and we are. We have two major problems on which we want to get your opinion: the tax holiday and depletion.

Now this seems to be the hard core of the mining industry. We don't have to argue that incentives are necessary. The White Paper agrees that they are necessary so there is that much wisdom in the White Paper on that point. Their proposal is that the tax holiday is no longer needed because there have been abuses.

Now would you address yourself to the two questions: that is the tax holiday in its present form; the possibility that is inherent in it for abuse; and what variation of a tax holiday, while you maintain the principle of it, would still leave the tax holiday as an incentive to the mining industry?

Senator Phillips (Rigaud): May I suggest an addition to what you have said? There was a point developed yesterday as to whether we can draw a distinction between the opening-up of new mines in territories that do not form part of the urbanized development of our country; that is, pioneer areas. I would like to ask whether special treatment should be given for the opening-up of mines in pioneer areas.

Mr. Kostuik: We do not recognize that there have been any abuses. The fact that there have been possibly three different situations in our country, or three that have been given great publicity because of

the very fortuitous circumstances of developing an orebody, does not by virtue of that fact make it an abuse. We believe the three-year tax exemption has developed our country and certainly the other incentive, depletion. Our view is that without the three-year tax exemption there is going to be little of our northern country developed.

I will ask Mr. Craig to develop your questions.

Mr. D. B. Craig, (Tax Manager, International Nickel Company of Canada Limited), member of Tax Committee, The Mining Association of Canada: Are you talking about the proposal of the Mining Association of Canada?

Senator Phillips (Rigaud): No. I am talking about the one developed yesterday by the International Nickel Company that there might be special treatment in respect of tax holidays for new mines. They do not include depletion.

Mr. Craig: The International Nickel Company took the position that perhaps the three-year exemption be slanted more towards the pioneering mining areas. The Mining Association of Canada I think is more concerned about the level of the exemption that would apply. One of the difficulties the Mining Association would have is some of its members regard the present exemption as satisfactory except from the point of view of limitation. There are many members of the Association, let us say from the Province of British Columbia which is starting to develop the industry in a great way, and they feel the present exemption with the limitation is satisfactory and does do the job of developing the area. Whether or not it is a pioneering mining area they say is really irrelevant. They say the incentive has been very worthwhile in establishing the mining area in the province.

I don't know the concept that International Nickel developed is entirely in line with what the Mining Association of Canada recommend. Part of the reason for that is one company can advance a position that not all members of the Association could completely concur with. I think the essential point here is the three-year exemption has been an extremely useful device in developing remote areas. As I understand the initial reasoning of the three-year exemption it was a multiplier impact on new mines. I think with the limitation on the exemption it still does two things: it still opens up new areas of Canada and still does provide employment opportunities not only for the mine but also the secondary and tertiary industries.

The Chairman: When you say "with limitation" what are you referring to?

Mr. Craig: In our particular suggestion we are saying that the three-year exemption should be limited to no more than capital input to the mine. If the capital input is recovered in less than three years then the measure of the exemption should be reduced.

The Chairman: What do you mean by "recovered"? Do you mean "earned"?

Mr. Craig: If your capital invested in the mine is fifty million dollars and you happen to acquire fifty million dollars of income during a year and a half that would be the measure of your limitation.

The Chairman: You mean you earn an amount equal to your capital input. Do you include the writing-off of any part of that?

Mr. Craig: You are suggesting: are you including any allocation of capital in the first place in the exempt period?

The Chairman: Yes.

Mr. Craig: No, that has not been developed in the brief.

Senator Phillips (Rigaud): Mr. Chairman, may I read into the record the last paragraph on page 8 of the brief? As you say, we have been waiting for the association, not for criticism but for guidance. The last paragraph, to my mind, deals with the fundamental point but dealing with it we don't deal with it.

The Association fully appreciates that the present incentive provisions are not perfect in every respect, and that some modifications might be devised to improve their effectiveness without increasing cost, or to reduce their cost without material loss of effectiveness. However, the basic issue at the present time is the question of the need for mining tax incentives in a general order of magnitude of those presently in effect. Discussion of details of form and approach would serve little purpose until decisions have been made on this basic issue.

The way I see it, Mr. Chairman, is that we are in agreement about the importance of the mining industry and we are all in agreement with the necessity of incentives. Certain suggestions have been made in the White Paper and various suggestions have been

made by constituent companies in the mining industry. The Chairman and his colleagues are now under obligation to absorb the variety of alternative suggestions made.

The simplest thing to do is to say, let us retain what we have. Various suggestions have been made, inclusive of this pioneer territory. We do not have a consistent suggestion from the constituent companies as to how to deal with it, other than the retention of the present incentive.

I am asking the Association what is the consensus of the Mining Association with respect to this point?

Mr. Kostuik: That has been an extremely difficult question among ourselves. I think if we bear in mind that the Association is made up of 120 companies it is very difficult to reach a consensus. For instance, I could give you examples of companies with which I have been associated for the last twenty or thirty years, smaller companies that are very dependent on the initial three-year cash flow that gives them money with which to develop a little further. Take the case of Kam Kotia, they take that cash flow and keep on developing and suddenly you have another community in there with another discovery at Timmins which makes that a very viable community. This is the effect it has on the smaller companies.

There are others, of course, who prefer to see the depletion part of it accentuated. Further on on page 24 we do say something about what we suggest regarding the three-year tax exemption.

Senator Phillips (Rigaud): In effect we have the ball to deal with the situation rather than hopefully trying to get a consensus applicable to the entire industry?

Mr. Kostuik: We say in our brief exemption during the three-year period to the capital invested to develop the mine. It should be limited to that. These would include pre-production expenses and also other assets which earn income. This would include roads, housing and docks and so on. We do make the suggestion, sir, on page 24.

Senator Phillips (Rigaud): What is your definition of the word "capital"? If you limit the effectiveness of the aggregate amount eligible for exemption during the three-year period of the capital investment does that include loan money and funded debt?

Mr. Kostuik: I would say yes.

The Chairman: I think Mr. Craig used an expression I like. He spoke about "capital input."

Senator Phillips (Rigaud): I wanted to be sure. The word "capital" is sometimes interchangeable with "equity."

Senator Cook: They include both debt and equity in their definition.

Are you familiar with the submissions that were made by the provinces, particularly Ontario and Quebec, to the Finance Ministers' meeting in Winnipeg last week?

Mr. Craig: Yes, we have knowledge of it.

Senator Cook: I think it is appropriate here to quote from the Quebec submission which was made. I would like to quote from page 16. They say this:

Similarly we are not opposed in principle to linking depletion allowances with the amount spent for exploration development. We believe that the definition of such expenditures should be broadened to include not only the cost of exploration and development for new mines but likewise those made to prolong the useful life of existing mines. From an economic point of view prolonging the operation of an existing mine often produces better returns than the discovery of new deposits. This applies not only to the industry itself but above all to the state which has to provide the interest structure needed for the development of a new area.

Would the Association agree with that statement?

Mr. Bonus: I think the answer might be yes. We have a statement at page 25, the last paragraph in section IV, which actually restate the principle in very similar substance.

Senator Cook: So you do agree. There are a great many other sections I could refer you to but on page 18 the following appears in the Quebec submission to the meeting of the Ministers of Finance:

In order to assure ourselves the necessary flexibility and to avoid having the depletion of mineral resources in certain areas stopped completely, provision must be made for the possible addition of an unearned depletion allowance, naturally not at the present level of 33-1/3 per cent but perhaps in the area of 15 to 20 per cent in certain mining sectors. In this way we

might find a solution for certain concrete cases which may arise and above all we would not discourage development. Would you agree with that proposition?

Mr. Bonus: Mr. Chairman, again I would like to refer to page 25 of the brief where we enunciate that principle without quantifying it by virtue of the fact we represent the whole industry.

Senator Cook: In other words, you think the principle of unearned depletion should continue to be recognized?

The Chairman: At some rate.

Mr. Craig: Yes.

The Chairman: Now the thing is not clarified as far as I am concerned. The McIntyre people made a suggestion that seems to be in line with what you are now saying although it was not too clear from reading their brief. For instance, if in the two years of the three-year tax holiday period you have recovered all your capital input your tax holiday is over. Is that your proposition?

Mr. Gibson: That is the measure.

The Chairman: It would only be then you would start to write off pre-production expenses, capital cost allowances.

Mr. Gibson: That is if we were a brand-new company, that is right.

The Chairman: The criticism in the White Paper which leads to the elimination of the tax holiday is that if you defer all your write-offs until three years are over this really effectively gives you six or seven years of freedom from taxes. As a fact that is correct.

Mr. Gibson: In some cases it would be, sir. The tax holiday in fact represents a very powerful incentive. In the case of a highly successful mine the effect of the incentive goes beyond providing full relief for the increased expenditures called for if a mine is to be successful. It may excuse a company from having the effect of keeping a mining project exempt from tax for a longer period than three years. In some instances this is the way in which the incentive has derived its power as an incentive.

It is quite clear to the industry from studies that have been made on the economics of mining that it

has a very significant effect. The curtailment in the three-year exemption is bound to reduce to some degree this incentive. It is the view of the Association that there would not be a major loss of the incentive effect is the total amount of exemption allowed was restricted to the amount equal to the capital investment in the mine.

The Chairman: We have had a suggestion from Richardson and Company of Winnipeg. It was to the effect that maybe there should be some check brain on the ability of the mining company to retain everything that it earns without tax and pile up its write-off until afterwards. If there was a percentage of pre-production expenses that they should be written off in that period and the pre-production expense total should have deducted from it a certain amount.

Mr. Bonus: I would like to comment on this aspect of it. I think we are dealing with two things here. I think it is quite wrong to say that the right to write off capital cost allowance after the tax-exempt period results in extending the tax-exempt period. It may in effect result in creating more tax-exempt income because during the three-year period your income is exempt you realize possibly more income as a result of not having to take your capital cost revenues. However, if we put a limitation, as we have suggested in our brief, of the capital input to the amount of exempt income then you resolve that problem. The other problem that the mining company has is that in the ordinary course of events a cash flow from the capital cost write-off provides the capital for renewal and continuation of the operations in the future without the necessity of again raising new capital. I think this is a normal process of any business, whether it is mining or otherwise. The capital cost provisions provide the cash flow out of which renewals are possible without continually raising new money or diverting income from shareholders.

Mr. D. H. Ford, (Director of Taxation of Noranda Mines Limited), member of Tax Committee, The Mining Association of Canada: I think it is important to say in this context that we are discussing at some length now the three-year tax exemption. I think our attitude is that it is the package which is important. I think the package has to result in mining exploration and development in Canada remaining competitive with elsewhere in the world. We are looking at the tax-free period as one part of it and the other part is the depletion allowance. Whatever this committee concludes that the incentive should be if it is not competitive with other areas of the world investment

in the mineral industry in Canada will decline and postponement of the tax under the three-year exemption will never be realized because there won't be taxable income in Canada.

The Chairman: Certainly the proposal that you have made in the limitation on the tax holiday period would deal with what has been referred to as the bonanza situation where you run into a jewellery store or something else and you mine out maybe in 18 months enough money to recover your entire capital input.

Mr. Ford: That jewellery store you have described is part of the great incentive that Canada holds. The occasional bonanza you can count on the fingers of one hand, I expect.

The Chairman: I speak of the jewellery store because I went underground in one property some years ago and saw it. I think they mined out enough in 18 months to pay off the money they borrowed. That is one sort of situation, I think, that may lie behind this. I have no connection with the White Paper except as a member of the Senate to form opinions and express them. If you are looking for a basis for what is said in the White Paper this may be part of the basis. People talk about a mine being so rich that it earns the entire amount of its cost in a very short period of time and therefore on that basis, recovery of cost, a tax holiday is not needed any longer.

Mr. Craig: Could I ask one other point which I think is worthwhile? The courts to a great degree are now dealing with what a new mine is. I think it should be understood that by no means does every mine opened in Canada enjoy tax-free exemption. There has been great uncertainty in the last year about what are new mines and the courts are coming near to deciding the issue. The build-up of jurisprudence in this is becoming very important and to some extent deciding this other issue. We are suggesting that limitation is the amount of the incentive and the courts to some degree are moving into the area of deciding what a new mine is.

The Chairman: You mean between whether it is an extension of an existing property or not. I was not moving into that area right away. There has been a suggestion here that since the mines presently operating came into operation under a certain set of rules those rules should not be changed as financing and public confidence are all based on that. Now how you could define those mines. . . . You say "presently operating mines." "New mines"; any mine that started

after V-Day, whatever that is. If you are going to have any changes the changes should only apply in that direction.

I would understand that most of the members of your Association have enjoyed the tax holiday period. Is that correct?

Mr. V. St-Onge, (Tax Manager, Quebec Cartier Mining Company), Member of Tax Committee, The Mining Association of Canada: We do hope to open up new mines. I would like to add to the comments which were made that in the three-year tax exemption there is an incentive feature which affects greatly, or less greatly, any one new mine depending on its profitability. It was mentioned that there might have been a few bonanza cases but in the majority of the cases those first years of opening up a new mine carry additional expenditure which reduces the effect of the new mine exemption. Certainly the Department of Revenue has been trying to cut from the stage of production the starting of the exemption and therefore in practice the beneficial effect of the exemption has been somewhat reduced because of that practice.

Another compensating factor of the three-year tax exemption for many mines is this situation: new mines in many cases have to be opened up outside of developed and civilized areas and all of the amenities and commodities which the public service provides the mining company has to provide in these circumstances. The mining companies have to invest a large amount of capital in the form of public services which elsewhere are provided by the province or even by the federal government. The three-year exemption to me it is one way of partially compensating for the investment which has to be made by a private company instead of the public government. The exemption in that way is a compensating factor and happily for some companies there remains after these payments an element of incentive but you never know beforehand what would be the proportion of the incentive.

Again it is explained that incentive actually leads into a spirit of risk undertaking without knowing exactly precisely what is going to be the result. The result has been good for certain companies but less for others and even where it has been lower this opening-up of a new mine, this development, has brought many benefits to the communities involved and to the revenues of the provincial and federal governments. Sometimes the less profitable companies have developed into much more profitable companies by improvements in technology and operation and administration.

Senator Phillips (Rigaud): Mr. Chairman, I would like to bring up a point raised some time ago before one of the mining companies. It is obvious that this whole problem arises in part due to public dissent about this business of tax holidays because of certain bonanza companies and the feeling of when is depletion not really depletion and when is it something else.

I think there is unanimity in Canada, certainly among well-informed opinion, that mining companies must have incentive benefits to extend and open up new territories.

The suggestion has been made, a revolutionary suggestion or a novel one, that we do away with the whole business of tax holiday and depletion and we assimilate a mining company to that of any other company that is out to make money, with deductibility related to normal rules of accountancy and normal rules of taxation. We simply say to those incentive mining companies that a percentage of income is subject to the then corporate rates that are in force in this country; say, half of its income, 60 per cent of its income, two-thirds of its income. We simply put the mining companies in line with any other companies in carrying on their operation.

If roads are open they will argue it is part of its expense; certain capital expenditures are incurred in order to get to the mine; all access problems normally arguable problems of deductibility against operating income. Simply do away with it, even the pioneer territory as suggested in the Nickel brief, and let business carry on with a view to making profits and recognize this industry for what it is, an incentive industry competitive to world markets. We would educate the public of Canada to say that X percentage of the taxable income is taxable at current corporate rates.

Mr. Kostuik: I am going to answer that question a little obliquely. We have no objection to other companies, other industries having incentives equal to ours. There is one hitch in there that we object to. We have the highest productivity of any industry in Canada. I might add, senator, our productivity in mining is even higher than in the States or any other country in the world.

Senator Phillips (Rigaud): I am taking your position that you are entitled to it.

Mr. Kostuik: It is the incentive that we have that has made it that way. It is by virtue of the government being very sympathetic that we have come to where

we are, strictly by the help of the governmental people. That is why we say this has to be maintained.

Senator Phillips (Rigaud): On an overall experience of the last ten years what proportion of normal taxable income of mining companies, ex depletion and ex tax holidays, should have been taxed in order to produce the benefit you have received? Is there a quick reaction to that in any form?

Mr. Gibson: That would be a difficult question to answer. May I add something to what has been said already? One of the points the industry is most anxious to make is that in roughly the present form of incentive changes could be made of some sort that would not seriously affect the economics of the mining industry. The mining industry certainly believes that the present form of incentives is a powerful package to the industry at as reasonable cost as could be achieved in any fashion. Now some changes could be made. The view put forward today is that it be developed in a form that would provide some degree of incentive. My own feeling is the amount of income that would have to be exempted from tax, or the proportion of income, would have to be rather low, so that in the long run we would be getting less in revenue than by providing the basic exemption at the beginning of the development of a new mine where it is most important to the mining venture. It is really much more important to the new mining venture to have the bulk of the incentive effect fall in the early years and in the long run it makes it possible to obtain a higher effective income from the continuing mining operation.

The Chairman: There is no question about it, Mr. Gibson, but that the tax holiday is part of a format that people look at who are contemplating risking capital in a mining venture. You have to earn it but if you earn it it does give you fairly immediate return of the money you have put into the development of the property. How much would the confidence of the risk capital group be affected? To what extent would it be affected if there was some change?

Mr. Gibson: This, of course, is a very difficult question.

The Chairman: I put it in this form to you because I understand from Mr. Craig and Mr. Kostuik that they are saying "Don't touch a hair on this child's head" in relation to the tax holiday. I want to know are there any we can touch and still not destroy the confidence of the risk capital people who provide the money and still to justice to the mining operation?

Mr. Gibson: That is a very difficult question for the industry to answer. The industry does not like to see themselves cast in the role of pleading for a continuation of incentives or special treatment. In fact the industry really did not feel itself to be in that role.

Senator Gelinas: The provinces have.

Mr. Gibson: I think industry has been looked up in that role as in effect pleading for special treatment.

Senator Gelinas: I don't think you should be too apologetic about that. The provinces, who are the ones who allow you to prospect, go out and find new mines and get a return, they say these incentives have to stay and that these incentives must be retained if we are going to have progress in this country.

Mr. Gibson: That is really my point. The industry's position is really that we are able to give some indication to you about the effect the present incentives have had on development of the industry. In the opinion of the members of the industry it is a powerful effect and a very suitable and well-designed one to provide a powerful effect on the growth of the industry and we believe it has a great deal to do with the development of the economy.

The Chairman: Mr. Gibson, there is no case for apology. The White Paper says the incentives are necessary. It is just the quantum of it.

Mr. St. Onge: Mr. Chairman, I think there is an impression that the mining companies which enjoy the three-year tax holiday pay absolutely no taxes. That is absolutely untrue. The provinces, and I am sure the federal government, recognize that starting with the first dollar which is spent in investment there is already 20 cents in that dollar invested which goes to the various governments at the provincial and federal level. There is a great contribution of investment dollars to the revenues of the provincial and federal government. During that same three-year tax-exempt period there are all other taxes, direct and indirect, which are levied on supplies and on the payroll and interest payments, and which are paid under the Mining Duties Act of the provinces, which are payable and which do offer a contribution to the revenue of the government.

The Chairman: We are recognizing all that; we are accepting all those assumptions. I gather the effect of what you say is that the tax holiday, subject only to the limitation that you have indicated, is needed to ensure the continuance of the operation of the

existing mines and the development of new mines and that the benefit to the company and to the country and to the national economy are such that nothing should be done to interfere or disturb or make it impossible that the mining industry would continue as it has been developed. Everybody assumes that you have been behaving like good corporate citizens. You have been paying any taxes you have been asked to pay. You have been paying property tax and you have been paying wages that you must pay to get workers and you have been providing them with purchasing power. You have been developing secondary industries in the areas. We don't need to argue.

Senator Cook: I think the point emerges, Mr. Chairman, that this is the point of view of the provinces. On page 13 of the brief it states:

The development of the Town of Thompson in Manitoba is a prime example; what was a wilderness in 1957 is now the third largest city in Manitoba.

I say "What about development in Labrador?" There are four places you mention here in Newfoundland: Buchans, Schefferville, Labrador City. Twenty-five years ago Labrador was just a virgin wilderness and now it has developed. I think the Province of Newfoundland, where I come from, has a real interest in keeping the tax holiday so remote areas can be developed.

The Chairman: Could we move to the question of depletion? That is the other point where we were waiting for you. The White Paper proposes only earned depletion. We have had evidence here that there are some mines that cannot earn depletion so that is why it appeared to be an intriguing suggestion we got recently that you divide between earned and unearned depletion. The suggestion the Nickel people made was that the unearned depletion should be at the rate of 20 per cent of the net, not the net production income but the net income before certain deductions, and then the earned depletion should proceed on the basis of one dollar for every three dollars spent.

I think the witness agreed with me when I asked the question as to whether that would roughly equal the present 33 1/3 per cent of unearned and produce the same amount. They indicated it would come close to it.

Mr. Craig: I think they did indicate that there would be an increase in tax incentive.

Mr. Gibson: That would yield something very close to the same.

Mr. Craig: It couldn't be more.

The Chairman: If you are a company, the development of which is valuable for Canada, and you are in a position where you cannot earn depletion, these companies would have nothing the moment the three-year tax holidays went. You cannot accept that proposition.

Mr. Gibson: Worse than nothing. They cannot pay the provincial mining tax.

The Chairman: Therefore it is not unreal and it does not injure the mining industry that depletion should be divided into different sectors. Many companies could earn both. They could take the unearned and they can also earn the other portion. Have you any objection to that basis?

Mr. Bonus: Mr. Chairman, the view of the Association is that of the two we would prefer the existing system but that if the concept of earned depletion is to be adopted then a two-tier depletion system might be acceptable as a second choice but we do not quantify the basic allowance in this respect because certain percentages might be applicable to some operations and not others.

The Chairman: Subject to that qualification. We have got to try and find some complicity in the formula to deal with that.

Mr. Kostuik: My problem is the 120-member companies.

The Chairman: I understand that they are putting forward their case and you are interpreting the effects of their cases.

Mr. Elliott, (President of Conwest Exploration Company Limited), Chairman of the Tax Committee, the Mining Association of Canada: We believe that the effect on one company would be vastly different than the effect on another. The effect of the two-tier depletion would be vastly different on some companies than on others as far as it affects taxable revenues. For that reason it is impossible for the Association to arrive at a quantitative amount.

Senator Phillips (Rigaud): It is a problem we have here which I tried to shunt over to the Association. We end up by having the ball, I suppose.

Mr. Elliott: You will have to rationalize it with the brief that you get from the individual companies.

The Chairman: To us these were the two major problems that we wanted to talk to you about. We recognize that foreign source income may well affect the earning of a Canadian mining company, depending where else in the world it has operations. Some of them, maybe an increasing number of them, may go to other areas for the purpose of balancing out the competitive situation. We understand what the problem is on foreign source income so far as the White Paper is concerned. Is there anything more on that you want to add in relation to foreign source income?

Mr. Kostuik: I don't think that we would, other than what we have in the brief, Mr. Chairman. Thank you.

The Chairman: Are there any other features? You are a representative organization and we don't want to miss the opportunity of getting any knowledge or any information we can get.

Mr. Craig: Mr. Chairman, the Association in its recommendation is saying that by placing limitations on the three-year exemption this results to a degree in diminution of the present incentive. We say as second best we accept the two-year depletion of earned and percentage depletion. To the extent that some members cannot earn depletion that, too, is a diminution of incentive. We have accepted the debate on the proposals and tried to arrive at a reasonable compromise. To that degree I think the Association has tried to be progressive. I hope that is realized.

The Chairman: We have not made any complaint to you about the viewpoint you have expressed. We have to rationalize the whole thing and we want all the help we can get.

You accept the definition we got some time ago about incentive that I thought was rather got. That is "incentive is something that reduces your taxes."

Senator Phillips (Rigaud): You mean on the first point, to get unanimity, you are speaking of the capital input in relation to the tax holiday. Secondly, as the lawyer said, without prejudice to the present position of depletion if we have to have the two-tier system then we move on.

Mr. Craig: Yes.

Mr. Ford: I wonder if the effect of the integration proposals on the mining companies in particular has been considered by your Committee? I suppose it has.

The Chairman: We are very fully aware of the effect. The expression I have used is "giving the company something with one hand and taking it away from the shareholders with the other hand." I think that just about describes the situation.

Mr. Gibson: There is one other rather serious aspect of the White Paper proposals referred to in the brief. That is in connection with the proposal that would affect the free movement of funds between companies where this is partly due to the integration proposals. It is not just a question of taking away the incentives that have been offered at the shareholder level. It is where one company has interest in other companies through shareholding arrangements, perhaps controlling interest in the mining company. The absence of provision for inter-company dividends between the companies as presently enjoyed would cause very serious problems, locking-in of funds.

The Chairman: I take it, as a general statement, and to the extent the industry would be affected, you are not in favour of integration as set out in the White Paper?

Mr. Gibson: That is correct.

The Chairman: It is not the first time we have heard that!

Mr. Elliott: I take it that our position on capital gains is not the first time you have heard that either.

The Chairman: No. We did speak about capital gains, didn't we?

Mr. Elliott: In the brief.

The Chairman: You do in the brief. I think the consensus among the general public might well be that there should be capital gains in some form but not in the form proposed in the White Paper.

Mr. Elliott: We agree.

The Chairman: Thank you very much.

The committee adjourned until 2.15 p.m.

Upon resuming at 2.15 p.m.

The Chairman: I call the meeting to order. The first submission we shall consider this afternoon is that of the Canadian Life Insurance Association. Mr. Hervé Belzile, the President of Alliance Mutual Life Insurance Company of Montreal is present. He will make an opening statement and introduce his panel.

M. Hervé Belzile, Président, L'Association Canadienne des Compagnies d'Assurance-vie: Monsieur le président, honorables sénateurs, permettez-moi, à titre de président des groupes de compagnies d'assurance-vie, de vous soumettre notre mémoire et de vous présenter les membres de notre délégation. Comme il a été mentionné, je suis aussi président de la Compagnie d'assurance-vie Mutuelle. Notre association compte 110 compagnies. Ces compagnies représentent 99 pour cent des plans d'assurance-vie et d'annuités au Canada.

These companies welcome the opportunity of expressing their views on tax reform, and hope that their submission and the opinions expressed today will be of help in your deliberations.

The submission is divided into three parts. The first deals with tax reform measures directly affecting policyholders. The second deals with tax reform measures affecting life insurance companies and through them company policyholders and shareholders. The third part looks at the savings and investment patterns in Canada in the decade ahead, and presents the germ of an idea for a savings incentive program that might be adopted in conjunction with tax reform.

Since our brief was submitted on June 5 the Minister of Finance has written to you indicating ways in which the tax burden implicit in the original White Paper Proposals might be reduced during the first five years of the new system. He, of course, indicated that the Government would have to review the situation in each year's budget. Our submission looks ahead ten years, and, frankly, the life insurance companies are gravely concerned about the perspective short fall of domestic savings with or without tax reform, and with or without the minister's changing the White Paper Proposals.

Our delegation includes the following: Mr. E. G. Schafer, Past President of the Canadian Life Insurance Association and President of The Dominion Life Insurance Company, Waterloo, Ontario; Mr. J.A. Rhind, Second Vice-President of the Association and President of The National Life Assurance Company of Canada, Toronto; Mr. W.J. Adams, Chairman of the Standing Committee on Taxation of our association, and Vice President and Secretary of The Equitable

Life Insurance Company of Canada, Toronto; Mr. T.R. Suttie, Executive Vice President of The Equitable Life Insurance Company of Canada, Waterloo, Ontario; Mr. E.H. McVitty, General counsel of The Manufacturers Life Insurance Company, Toronto; Mr. J.W. Popkin, Senior Economist of the Sun Life Assurance Company of Canada, Montreal; Mr. R.D. Radford, Associate Treasurer of The Canada Life Assurance Company, Toronto; Mr. G. C. Campbell, Tax Consultant of the Canadian Life Insurance Association of Toronto.

Also in attendance are Mr. J.A. Tuck, Managing Director of the Association and Mr. F.C. Dimock, the secretary.

Nous espérons, honorables sénateurs, que vous ne serez pas trop surpris du nombre de nos représentants.

Five or six of the company officers I have named have special knowledge of particular parts of the brief. I would therefore propose, Mr. Chairman, that the questions of your committee be directed initially to Mr. W.J. Adams, Chairman of our Tax Committee, and he will ask one particular person in the delegation to make particular replies.

I hope in this way we will be able to give you quick, sound and useful answers in order to profitably use the time we have available. With your permission, Mr. Chairman, I will ask Mr. Adams to add a few words to my opening remarks.

Mr. W.J. Adams, (Vice-President, The Equitable Life Insurance Company of Canada,) Member, Canadian Life Insurance Association: Thank you. Mr. Chairman, honourable senators, we felt it might be helpful if I took just one or two minutes to explain the rationale and purpose behind our brief. I think you will find it is a different kind of brief than anyone else has submitted to this committee. This is because our business is in the unique position that the major part of tax reform and tax change has already been brought about by the special life insurance taxation legislation, passed a year ago in June, embodied in Bill C-191.

We are, therefore, primarily in our submission drawing to your attention some of the problems, inequities and difficulties which a year's experience with this legislation disclosed to us. We particularly draw attention to some of the problems we see if the general tax reform proposals outlined in the White Paper are superimposed on this very special legislation, because obviously the White Paper proposals have been devised with the general situation in mind and not just this particular one.

In our brief Parts I and II are concerned mainly with the effects of these two tax proposals, one of which is law, on the 11 million life insurance policyholders in Canada. Incidentally, nearly half of the 11 million are not income taxpayers. We have little to say in our brief about the effect on the proprietary part of life insurance, the shareholders, where, by and large, are treated similarly to shareholders in other corporations. We do not take a stand on such proposals as integration or the difference between widely-held and closely-held corporations. We do emphasize, however, that whatever decisions are taken in an area such as integration, special rules must be made since we are already, in the present legislation, subject to very special rule for dividend credits. It is called the prorating rule and it applies only to life insurance companies.

Similarly, in connection with the distinction between widely-held and closely-held corporations, we point out that some special rules must be made since mutual life insurance companies and the large mutual element in stock companies do not fall within the accepted definitions of either widely- or closely-held corporations. This presents special problems, but in all of these matters we have made positive and, we hope, constructive recommendations for your consideration.

In Part III we report on the economic studies we have made of the effects on new capital formation and economic growth of both the June 1969 legislation and the White Paper proposals. We then proceed to make constructive suggestions for the creation of new sources of capital formation to help fill the predicted gap between new savings and required new capital over the next decade.

I think, sir, that sums up our brief.

The Chairman: Mr. Adams, in summary form what would you say are the features of the White Paper that give you the greatest concern?

Mr. Adams: I would say, Mr. Chairman, that as a life insurance company one of the things that gives us the greatest concern is the prorating of dividend credits, which was part of the 1969 legislation and has had the unintended effect—we are sure it was unintended as far as the legislation was concerned—of providing a disincentive to life insurance companies for investment in equities. This is an important point and we would like particularly to show the impossibility of adding integration on top of that without changing one or the other because the two just do not fit together.

The Chairman: The White Paper does not give you any answer?

Mr. Adams: No. The White Paper deals with the general situation.

The Chairman: What do you recommend?

Mr. Adams: Mr. Radford will discuss this. We recommend, basically, that the prorating, which only applies to us and not to any other financial institution, be abandoned in which case normal integration would work.

The Chairman: What would be the difference between the two, so far as a source of tax revenue?

Mr. Adams: Mr. Radford, would you care to make an estimate on that? We had a "horseback" estimate this morning.

Mr. R. D. Radford, (Associate Treasurer, The Canada Life Assurance Company), Member, Canadian Life Insurance Association: We did make an estimate this morning and it would be "horseback." I think we estimated it might be a loss of \$5 million, between \$5 million and \$10 million, to the general revenues of the Government of Canada. We did propose this morning that we would investigate this area and come back with sharper figures. It is rather difficult since we even do not know at this stage what our 1969 tax position is as a company or as an industry.

The Chairman: The two cannot work together, is that right?

Mr. Radford: As the current law stands on life insurance companies, and as we interpret the White Paper and the intent of integration and capital gains tax, as you try to mull the two together, in effect, put integration into the life Insurance Company taxation formula, you do not get the answers that you believe the White Paper intends you to get. In fact, you end up looking like you would pay more taxes and you do not get the credit going to the policyholders and shareholders. This is not really the effect of integration, this is the effect of our formula, particularly, the prorating aspect of it.

Mr. Adams: Would it help if Mr. Radford explained just why the unexpected effect of this prorating aspect has lead to a disincentive investment in common stocks?

The Chairman: I expect the answer is that the proposals in the White Paper make other stocks look more attractive.

Mr. Adams: No. This situation was there before the White Paper.

Mr. Radford: In the introduction of taxation, if you look at the laws it was said there were three participants in life insurance company income: the participating policyholder, who participates in the earnings by dividends; the non-taxpaying policyholder—the non-par policies prior to October 22, 1968, and all pension plan policyholders in which life companies have a large part of the pension business in Canada; and the corporation itself, the corporate entity. They tried to split the income among three groups. In doing so they came up with the prorating idea of allocating income in ratios. As you look at each item they do not look bad. The policyholder is taxed at 15 per cent and gets a 20 per cent tax credit. I am talking of dividends of common stock now. Dividends are attributed to a pension plan. They do not pay any taxes and do not get any credits, which is an argumentative point. The dividends go to the corporation, which does not pay any tax. In a static view it looks like this is what the law says and what has been imposed correctly. As soon as one starts a dynamic view and adds a dollar of income from a variety of different sources, because of the prorating effect you suddenly find that if you have a dividend increase to a life insurance company and it has, as the hypothetical company has in Appendix A, a certain split of business common to the industry and not a unique split—a dividend from a Canadian corporation suffers a tax load of 36 per cent, whereas a dollar of interest from mortgages or bonds would suffer a tax load of about 48 per cent. This is not an incentive for life insurance companies to buy common stocks, in fact it becomes a disincentive.

The Chairman: This is the problem that presently exists.

Mr. Radford: It presently exists and, as I say, integration just seems to compound it. All of a sudden you are dealing with non-money, you are dealing with a tax credit.

The Chairman: You understand our position, of course: we are dealing with the White Paper. We can look at the effect that the White Paper proposals might have on any existing situations, but we cannot suggest amendments to the Income Tax Act. That

would be beyond our scope of reference, which is to consider the White Paper proposals, hear and examine witnesses, and make a report.

Now, your problem is noted on the record and it should be passed on, if you have not already seen to that.

Mr. Adams: The solution that we suggest, changing prorating, would enable the White Paper proposals to work.

The Chairman: Well, you just fit it into the general run of companies. How would you arrive at your allocation of dividends? You would still need something for that, would you not, among the different groups?

Mr. Adams: Yes.

The Chairman: You need that part of it.

Mr. Adams: Yes. If you would like me to go on, the second most important thing is part III of our brief which deals with the economic aspects and our concern about the short fall of savings in the future and the positive recommendations we have for helping to correct this situation. If I may, I would like to call on Mr. Popkin to speak on this subject.

Mr. J. W. Popkin, (Senior Economist, Sun Life Assurance Company of Canada, Montreal), Member Canadian Life Insurance Association: The main burden of our argument here is really that we look at the decade ahead and at the investment needs to finance a fully growing economy, or an economy growing at its full potential, and with full employment opportunities.

We look on the other side at the same strains as we see them developing. Even without the proposals in the White Paper, there seems to be what might be called a savings gap, which means that we have to call on external capital. We have estimated—these estimates are rough, of course, but they are our best estimates, and I think they would be supported by further studies—we have estimated that by 1975 we have to call on external capital if we want to maintain our potential growth pattern to the extent of \$2.3 billion and by 1979 \$2.9 billion. As we look at the negative effects on the saving of the White Paper proposals, if they went in as originally proposed, these deficiencies through the savings gap would rise by 1975 to \$3.2 billion and by 1979 to \$4.4 billion.

These figures just give you a perspective on it. In 1969 our net inflow of capital, long and short, was \$778 million.

We say two things about this. First, whether it is desirable, even if it were practical, to have that volume of capital inflow over the years ahead. I think a real question arises whether this amount of reliance on external capital is desirable. Further than that, we have very grave doubts that in fact we shall be able to call on this extent of capital because of the whole global capital short position.

Senator Beaubien: What do you need for capital for?

Mr. Popkin: We need the capital in order to finance . . .

Senator Beaubien: Not the business you have on your books. It will not be for the business you have on your books.

Mr. Popkin: It is the capital required to employ the people in Canada.

Senator Beaubien: For the general development of Canada.

Mr. Popkin: The general development of Canada.

The Chairman: To establish a base for selling more insurance.

Mr. Popkin: We are taking a very broad view of this whole question of savings. We are part of the savings process, but we are much more concerned with the growth of Canada, not only for our own interests but for the interests of everybody.

The Chairman: A number of groups who have appeared, including Richardson Securities, have emphasized the effect of the drain on savings through increases in tax in the personal sector, and also in small business, and the need for substantial capital, both kinds, risk capital and what might be called regular, so there is no question about there being a problem.

Mr. Popkin: People have the idea that the United States is a completely open market, that it is a very large capital market and there is really no problem of tapping that market to almost any extent we desire. It is interesting that the assistant director of the budget of the United States only yesterday, Mr. Mann,

warned that capital market conditions in the United States during the 1970s may be more severe than those experienced in the past decade; long term financial markets may be called upon to supply as many dollars during the first half of the 1970s as they supplied during the entire decade of the 1960s. In other words, the United States has an even more severe problem with financing coming up.

The Chairman: That just emphasizes the competition that will go on for capital.

Mr. Popkin: It emphasizes the fact that if we try to rely completely even on a big market like the United States we may be disappointed in our ability to attract funds at a sort of economic, competitive rate.

The Chairman: Would you spell out the short fall in the availability of capital so far as you are concerned? What would be the effect?

Mr. Popkin: There is only one effect. The effect would be that we would have to be content with a lower growth rate and a higher rate of unemployment as an average over the decade. There are four potential streams of saving in Canada that we can really look to. There is the personal sector, which supplies about 50 per cent of the total Canadian savings: There is the business sector, which for ten years now has been a dis-saver. They have been calling on funds in the external market. For some years just after the war they were net savers, in the sense that their retained earnings plus depreciation allowances were on average more than enough to finance their capital spending. This has not been true for the last ten years.

As we look at the technological process, the effect of inflation on the adequacies of depreciation allowances, we find that rather than business becoming a net addition to saving, it will actually be calling more on savings as the decade proceeds. In other words, it will be demanding more capital, more savings, more demands on savings, than currently.

If you look at the government sector on balance, we do not feel that we can count on the government sector to be a net saver. At least, at times they are savers, at times they are dis-savers; but looking over a broad range of years we figure that they are a zero factor in the saving process. You are therefore left with the external sector, and if we cannot increase the savings at the personal sector and cannot get it from the external sector, there is only one answer, and that is to be content with a slower rate of growth.

Senator Beaubien: How important are the pension funds as savers?

Mr. Popkin: The pension funds are quite important. One of the problems here, and the question that comes up all the time is when you say: "Why are you worried? Let us say the government could always run a surplus. Is this not the same thing as the private sector creating the savings itself?" Our answer to that is: no, it is not an either/or proposition. The way we look at it is that investment in the private sector and investment in the government sector have a complementary nature. It has to go forward. There is no sense building a road unless you have something at the end of it, mine or a resource of some kind, or a factory.

It is the same with education. There is no point in spending millions of dollars, as we do, on education, unless there is the technology and the investment to finance the technology to put this higher educated working force to work. The higher the education, the more technology, the more financing you need for this higher technology. So I say the two go together. You cannot starve the private sector and expect the surplus of savings in the government sector to make it up, even if you could rely on savings in the government sector.

The Chairman: What do you suggest?

Mr. Popkin: As we look at all the areas, the only place we can see there is a possibility of getting increases in savings, some stimulant, is in the personal sector, and this is what we have come down to. We have done some research. We have not got the whole answer to this. All we are doing is suggesting this as a profitable way to try to increase the savings stream. We are suggesting that we should try to beam it in the sort of lower income groups, let us say the income groups from \$3,600 to \$10,000, \$11,000 or \$12,000.

The reason for doing that is that any stimulant to saving has one potential weakness, and that is that you end up subsidizing savings which will be going on already. What we tried to do in this proposal of ours is to give a stimulant that will really get new savings, get people to save more, not just subsidize saving which is already going on.

We feel we can do that better if we give the stimulus to a savings group of \$10,000 or \$12,000 and under. There is nothing magical about the \$10,000 or \$12,000, except as you go up the income scale you tend more and more to subsidize savings rather than encouraging new savings.

The Chairman: If you made a change in the proposed income tax rate in the group from about \$9,000 to \$24,000 you might generate more savings.

Mr. Popkin: Yes, that is right.

Senator Beaubien: That would be a downward adjustment.

The Chairman: If you made a change downward, yes.

Mr. Popkin: The effect of the White Paper, as we see it on savings, is that in the income class from \$3,600 to \$10,000 there is a stimulus to savings through the lower rates which amounts to about \$30 million a year. On the other hand, there is a detriment to savings on the income class from \$10,000 and above which amounts to about \$125 million a year.

The Chairman: The lower group is not really the savings group.

Mr. Popkin: That is surprising. This is a difficult area on which to get statistics. There is no basic savings figures, or a correlation between the amount of savings and the assets holdings. We do have figures on assets holdings. If you correlate these two, you will find that 45 per cent of the total personal savings is done by the income groups between \$3,600 and \$9,600.

The Chairman: Forty-five per cent?

Mr. Popkin: The total personal savings. The average amount of savings in those groups is something like \$250 a year. The reason it is so much is that there are 4.5 million people in these particular income groups.

The Chairman: The White Paper says that the increased tax burden in that middle group, whatever you want to call it, say between \$9,000 and \$10,000 and \$24,000, is only about \$70 million.

Mr. Popkin: But the savings impact on that is above \$10,000.

The Chairman: How much credit would that generate as well as actual savings?

Mr. Popkin: There is a credit potential there.

The Chairman: About \$400 million of the increase in tax revenues to make up for the loss in tax revenues come from small businesses in the fifth year.

Mr. Popkin: That is right.

The Chairman: That may well have been quite an impact on savings, but I do not know.

Senator Beaubien: Mr. Popkin, when you say savings, is that every kind of savings, such as paying off a house or something?

Mr. Popkin: Our figures exclude the equity which people have in houses but include almost every other type of savings. It does exclude some types of guaranteed pension plans and private plans. They are the best figures we have and we specifically exclude equity and housing. That really does not come into the capital market.

Senator Beaubien: Do you exclude anything they might get out of a pension plan?

Mr. Popkin: That is right.

Senator Carter: Do you have any figures of income groups for the taxable group from \$1,000 to \$5,000 and \$5,000 to \$10,000 and the percentage of them who take out insurance policies?

Mr. Popkin: I think the average policyholder in Canada is something like \$6,500.

Senator Carter: The average income?

Mr. Popkin: Yes.

Senator Carter: I was rather surprised to hear the amount of savings there was in this low income group. While the amount would be less, I was wondering whether the proportion was comparable to other higher groups.

Mr. F. C. Dimock, Secretary, The Canadian Life Insurance Association: This relates to the purchases of individual life insurance policies during 1968, the most recent year we have. Seventy per cent of the policies were bought by income groups between \$3,000 and \$7,500 a year. Does that help?

Senator Carter: Yes.

Mr. Popkin: We have constructed a table which will give you this information. It is our own table with the statistics of asset holdings. It comes out to something like this.

The Chairman: I wanted to follow up something Mr. Dimock said. There is nothing in the White Paper which touches on individual rates that would increase the tax burden in that group.

Mr. Dimock: That is true, yes, sir.

The Chairman: Because you have the 750,000 who get off the tax rolls completely and then you have the next group who get the benefit of the increased exemptions and who only become taxed out of it by the time they get to about \$8,000 or \$9,000. In the group you were talking about there would be little if any impact by reason of the personal income tax rates. Is that not correct?

Mr. Dimock: That is true. Incidentally, the 70 per cent of the policies are smaller ones than average. They account for 54 per cent of the total face amount of policies.

Mr. Popkin: I will run through a few of these classifications. Up to \$2,500 income there is 18 per cent of the population in this income class. They have 5.8 per cent of the income. They have assets per family of \$950. The percentage of the total savings in this particular class is 2 per cent, and the average savings per taxpayer is \$45. The income class from \$2,500 to \$5,000, which is 38 per cent of the total population, represents 25 per cent of the income, and the assets per family average \$3,000. They do 12 per cent of the total personal savings. The average savings per taxpayer is \$149. From \$5,000 to \$7,500, which is 30 per cent of the total income assets per family, it is \$6,500. They do 20 per cent of the total personal savings, and the average savings per taxpayer is \$357. From \$7,500 to \$10,000, which is 10 per cent of the population, the income is 15 per cent of the total. They have assets of \$11,800 and they do 13 per cent of the total personal savings with an average saving per taxpayer of \$644. These are rough figures that we have put together. We have not put our proposal in very specific terms because we think it needs a lot more research.

The Chairman: You have told us the problem in outline.

Mr. Popkin: Yes, that is right.

The Chairman: And you have told us what will be the results if the White Paper proposals are implemented?

Mr. Popkin: I think the White Paper just makes the whole problem that much more difficult.

The Chairman: Is it because overall it takes a very substantial increased amount out of the private sector and transfers it to the Government?

Mr. Popkin: No. That would be an even greater irritant. Even without that there is difficulty with respect to domestic savings. We think the effect of the White Paper would be to cause a decline in domestic savings of something approaching \$1 billion by the fifth year, and this is against the picture of a deficiency in domestic savings even before the tax proposals are put into effect.

The Chairman: If you do away with integration you will save, under the White Paper Proposals, about \$140 million.

Mr. Popkin: That is right, but our suggestion is that we need to give serious attention to more stimulus for personal savings, and particularly at the lower income levels. We are suggesting a tax incentive system which we think could raise, depending upon how it is structured, something like \$600 million in additional savings at the personal level, while the tax revenue lost to the Government would be some \$250 million. It could be structured on this basis, but if you want a higher level of savings then you have to balance that off against a decline in revenue.

The Chairman: You are continuing your studies, are you?

Mr. Popkin: We are hoping to encourage the Government to go into this much more fully. We put this up as an area for additional research, and strongly urge that we need this kind of savings stimulus. We hope that this committee will make a strong recommendation to the Department of Finance, or the appropriate authority, that research be done in respect to instituting some sort of savings stimulus at the personal savings level.

The Chairman: This is an argument in support of some of the representations we have had, that the implementation of the White Paper Proposals, to the extent that they are to be implemented, should proceed slowly. One suggestion was that if you are going to implement the capital gains tax then that is a big enough mouthful to occupy us for a couple of years, and more study can be done on the other aspects. Is this the sort of thing you are thinking about?

Mr. Popkin: I would say that even if the White Paper were dropped today we would still need a stimulus at the personal savings level.

Mr. E. G. Schafer, (President, The Dominion Life Assurance Company), past President, Canadian Life Insurance Association: We do have one type of savings plan outlined here, but we are not saying it is the best. Would it help if Mr. Popkin explained the kind of savings plan we have described, and the reasons for it?

The Chairman: Of course, you have to make the assumption that we have read it, and that our staff has read it, and that we have received certain comments from our staff.

Mr. Schafer: I do not think Mr. Popkin has given the reasons for this particular type of savings incentive, or compared it with some of the types you find in other countries such as Japan.

Mr. Popkin: As I say, in designing a program of this sort there are several problems. You have to make sure that you are not subsidizing old savings. I think we have to have some sort of limit, otherwise it could be very expensive from the point of view of government revenue loss. What we are saying is that if you establish a limit of \$600, and some sort of authorized savings certificate, it could be operated something like a registered retirement savings plan. You would have a savings certificate of a financial institution. The reason for that is that it creates stability—a contractual obligation that gives stability. We feel it should be tied up for a minimum of five years. It has to be tied down to a period of years in order for this money to be invested in long term form, such as housing, and plant and equipment, and that type of thing.

The savings would be tax exempt, and taking the average marginal rate at 20 per cent, it would mean that for every dollar saved the individual would get a 20 per cent tax exemption.

Let us suppose that the average individual saves \$150 a year, then by this method you might encourage him to increase his savings to \$300 a year, and in that case you are only subsidizing \$150 of new savings. This is where we think we can get about \$600 million in additional savings for a tax revenue loss to the Government of something like \$250 million.

Senator Carter: Are you saying that a person who saves \$600 a year would get a tax credit of \$120?

Mr. Popkin: No, he would get a tax credit on the full amount. If his rate is 20 per cent, he would get a tax credit of 20 per cent on the \$600.

Senator Carter: He would deduct that from his income?

Mr. Popkin: Yes, that would be treated in the same way as a contribution to a registered retirement savings plan.

Senator Beaubien: Mr. Popkin, if somebody buys 50 shares of Bell Canada, would that be considered as savings?

Mr. Popkin: No, you would have to create a special instrument.

Senator Beaubien: I was not thinking of your plan, but of your calculation of the total savings. Do you take into account the savings of people who buy stocks? How would you know that they bought stocks? How did you calculate the amount of savings every year?

The Chairman: You are talking about a compulsory savings plan, are you not?

Mr. Popkin: No, it is not compulsory. There would be a tax incentive . . .

The Chairman: How do you make sure they hold on to their savings?

Mr. Popkin: Well, as I say, you would have to have a special certificate or a special liability, which could be with a bank, a mortgage company, or an insurance company. It could be with a *caisse populaire*, or any recognized institution of saving. It would be held in just the same way as a five-year savings certificate in a bank is held.

The Chairman: When you direct the way in which the savings shall go then it is a form of compulsory saving, is it not?

Mr. Popkin: You do not direct those institutions. They will put the money where they think they can get the best return.

The Chairman: You are not going to leave the money with the individual.

Mr. Popkin: No.

The Chairman: It is going to go somewhere?

Mr. Popkin: Yes, in a savings institution.

The Chairman: And it will be saved on the basis that there are penalties. He will have to pay additional tax if he draws the money out?

Mr. Popkin: That is right. When the certificate matures, let us say, at the end of the five year period then the individual will have to pay tax on the income at his marginal rate.

The Chairman: I would have called that a form of compulsory savings, but the name does not matter.

Mr. Schafer: It is the same as the registered retirement savings plan, only for a shorter term.

Senator Carter: Would there be a capital gains tax when the individual takes that money out?

The Chairman: We will come to that when there is a gain.

Senator Isnor: Did you say that 70 per cent of life insurance is sold to people with incomes of between \$3,000 and \$7,500?

Mr. Dimock: That is as to the number of individual policies held in Canada. Of course, it is based upon a small sample.

Senator Isnor: But the fact remains that 70 per cent of your business is with the class of people with incomes between \$3,000 and \$7,500.

Mr. Dimock: Seventy per cent of the individual policies in 1968 were bought by people with incomes between \$3,000 and \$7,500, and those policies represented 54 per cent of the total amount of insurance.

The Chairman: I notice you have an item in here concerning lump sum payments, which might have a bearing on this.

Mr. Adams: I was going to suggest that we consider that one next, or blended payments. I would like to ask Mr. Suttie to tell us about this.

Mr. T. R. Suttie, Executive Vice-President, The Equitable Life Insurance Company of Canada: We have two sections in our brief dealing with lump sum

payments. One deals with refunds from pension plans. Currently any lump sum refund is taxable under section 36 of the Income Tax Act on an averaging basis. The White Paper proposes that section 36 be withdrawn, and that tax be paid under the general averaging provisions. This would impose a high marginal rate of tax, and almost certainly a higher rate of tax would be imposed on the individual who had been saving during the period of contributions than he would have paid if he had been saving the money in his own hands and paying tax year by year. So there is a penalty on that lump sum refund in the way the White Paper proposes taxing it. We feel that this is particularly harsh when applied to lump sum payments on the death of the member of the pension plan, when the payment as a lump sum is usually the most appropriate form of payment. The White Paper suggests that the lump sum payment can be used by the recipient in the form of income over a period of years, but for a widow with young children that would be quite inappropriate. The payment is normally made as a lump sum, and we feel it is very wrong to actually impose a tax penalty in those circumstances.

The other problem concerns such things as endowment policies or savings certificates which are currently taxed under section 7 of the Income Tax Act, dealing with blended payments of capital and interest. They currently have the benefit of section 35 of the Income Tax Act which, again, pays tax at a favourable averaging rate.

The White Paper does not refer to section 35, but there is an implication that that probably would be withdrawn as would section 36. Again, the impact would be that the individual would pay a higher rate of tax when he received this lump sum payment, which might be the result of savings over 20 or 30 years. He would pay a higher rate of tax on the portion treated as being interest than if he had held an investment himself over a period of years and paid tax each year on the interest. We believe it is wrong to impose a higher rate of tax on the man who is engaged in the form of long-term savings particularly, as very often is the case, when on that policy he would have paid his premiums over a long period of time when he himself was subject to a lower rate of tax than that period when he received the lump sum. In this case there has been no incentive to him by way of tax concessions. He has not received any tax credit on his premiums. The interest income has been taxed in the hands of the insurance company or other institution during the period of savings, so there is no justification for treating him harshly when he receives payment.

We recommend that section 35 or something equivalent to section 35 be retained both in equity and to encourage long-term savings. For the reasons Mr. Popkin has already indicated, we think it wrong to discourage anything of this type.

The Chairman: You also recommend retaining section 36.

Mr. Suttie: We feel there is a distinction between section 35 and section 36, Mr. Chairman, because section 36 deals with payments where the individual has received some tax concessions when he has made payments. He received deductions from his income on his contributions, and the accumulation has been tax-free. We do not say outright that section 36 should be retained, but we do not feel that the provisions should be as harsh as the White Paper would indicate. We feel the tax rate should not be higher than the tax rate the individual would have paid from year to year if the money had been taxed in his own hands.

We think it is legitimate to give some actual encouragement to long-term savings by retaining section 35.

The Chairman: Mr. Adams, do we agree on the next point? I named the last one. Now, you name yours this time.

Mr. Adams: I think we covered the major ones. There is a minor one we feel should be a part of tax reform. Mr. Suttie might also comment on this one. This is the use of annuities as an investment under deferred profit-sharing plans.

Mr. Suttie: This is a highly technical point, Mr. Chairman, in a sense it is not contained in the White Paper, but we do take this opportunity of putting it on the record. When section 79(c) was amended in 1966 to prevent what was considered to be abuses of the use of section 79(c), restrictions were placed on the types of investment which could be made, and certain types of life insurance policies were defined precisely as being eligible investments. The Department of National Revenue has interpreted those definitions to exclude annuity contracts. In our opinion an annuity contract is a highly suitable form of investment under section 79(c), and we feel it is merely a drafting error that has excluded those.

The Chairman: I am just trying to see how we can relate this to the White Paper. What do we do?

Mr. Adams: In some of these, sir, we are following the invitation of the Minister of Finance to suggest reforms that seem necessary to us.

The Chairman: It could go under that.

Mr. Adams: That is the one we put it under, as well the prorating.

The Chairman: As a matter of fact, the prorating might come under that. The minister is inviting you to express your views. If we put them on record here they will get to him.

Senator Molson: What other funds are excluded in that section? You mentioned annuity funds. What else is excluded?

Mr. Suttie: Life insurance policies have been defined in such a way that the eligible life insurance policy, in effect, has to be an endowment policy maturing at age 70 or earlier. This was done because section 79(c) was being used to fund buy-sell arrangements between major shareholders, which was clearly not the intention when it was introduced. There is no objection to the definition which excludes a whole life insurance policy, but we feel that an endowment at 70 is an appropriate instrument, that a pure deferred annuity is indeed more appropriate and that it was just a drafting error it was excluded.

Other investments excluded which do not affect us as companies are primarily investments in the shares of the employer himself, unless the share is quoted in the stock market to avoid the use of it to purchase shares in a private company.

Mr. Adams: Perhaps we are conscious of this business of withholding tax for pensioners. Being in the business, we are paying pensions to many people who retired 20 to 25 years ago and who are living outside Canada. Up to now their pensions have not been taxed. The proposal in the White Paper for a withholding tax of 25 per cent is not only for those doing that in the future, which we don't quarrel with but it is retroactive.

The Chairman: Have you made a study in dollars of the areas that would be affected? What types of income or amounts of income would be affected?

Mr. Adams: We have made no study of this kind. It would be difficult to do so, but I happen to know of a few cases in our own company of people retired. I was thinking of one man who chose to live abroad where

\$4,000 could do a more adequate job. Today he is barely able to manage, even abroad, on that, and arbitrarily to reduce that to \$3,000 seems a very harsh measure indeed for the sake of the small amount of money you could raise, for the sake of curing the abuse perhaps of the millionaire who has done this.

The Chairman: That is why I was thinking of you, as it were, breathe these things and see the various types, there might be more value than simply making a general statement.

Mr. Adams: Perhaps the suggestion could be made that below a certain amount they not be retroactive.

The Chairman: Why do you put that limit, and not retroactive? Why any limit? If the principle you are asserting is good, would you say pensions that have currently fallen in have built into them some kind of an escalation, that they would not be adversely affected by the same thing?

Mr. Adams: I am simply saying that many people have made their decisions based upon the tax situation as it existed at the time. People who are making decisions for the future must make them based upon the future tax situations. We think it is unfair, therefore, to make it retroactive.

The Chairman: The simple way of dealing with it would be by a dollar amount. What dollar amount would you suggest?

Mr. Adams: I have no suggestion in that respect.

Senator Molson: It would be tied to the cost of living index, Mr. Chairman.

The Chairman: I suppose you might at least make it the amount where people who are living in Canada would have a tax-free income.

Mr. Adams: Yes.

Senator Molson: I might remind you, Mr. Chairman, we had at least one letter from somebody at pensionable age, who because of the rapid rise in the cost of living in Canada said that he and his wife would not really be able to get by, and they were looking round the world for cheaper places to live. Then the White Paper came out and said that the withholding tax would be increased to 25 per cent, and he wrote to us, rather desperately I thought, and brought this point up. I would suggest that the impact of this is on the very small pensioner entirely, either past or future.

The Chairman: Maybe in the area of what, \$3,000 or \$4,000?

Mr. Adams: I would say at least that high; maybe more than that.

The Chairman: It is a question that you have to relate the exemption on what you are doing for other people. However, it is a point that we should really deal with.

Mr. Adams: It certainly deals harshly with the people who can least afford it.

The Chairman: That is right. Does that cover the points?

Mr. Adams: I think that probably covers it, unless any of my colleagues care to emphasize some points that we have not discussed.

The Chairman: You can assume, as I told you before, that the brief has been analyzed.

Mr. Adams: Thank you, sir.

Senator Isnor: The companies represented here today are from Ontario and Quebec. Have you any other members throughout Canada?

Mr. Adams: Yes, sir. This brief has been put together by some six subcommittees, involving 48 experts in many fields from companies right across Canada. The people here today happen to be the chairmen of some of these subcommittees, but each of them has had many other people working with them from the companies of every size, resident and non-resident, located everywhere in Canada.

Senator Isnor: I see that seven come from Toronto, two from Waterloo—which makes nine from Ontario—and two from Quebec. Are any companies in the Maritimes members of the association?

Mr. Adams: Yes, indeed they are, sir, and they have contributed to this brief. I think the answer is that the larger companies are the only ones who can afford to release expert personnel, and they have had to spend days full-time working on this for four years now since the Carter Report was released. Smaller companies just have not got the personnel to devote full-time to it. This is the contribution the larger companies have made, who happen to be located in central Canada. I think that is the simple answer. Perhaps Mr. Tuck can elaborate on that.

M. J. A. Tuck, Managing Director, Canadian Life Insurance Association: There are 110 companies in the association, and this submission was cleared with all of the companies, including the Maritime Life. We have another member company in the Maritimes, in Moncton now, and we have companies right across to Vancouver, some non-resident companies as well.

The Chairman: Thank you very much.

Mr. Belzile: Thank you very much, Mr. Chairman.

The Chairman: The last submission we have today is from the Insurance Bureau of Canada. Mr. Piper will make the opening statement on behalf of the bureau.

Senator Asetline: Is it non-life?

The Chairman: Non-life yes.

Mr. E. H. S. Piper, Insurance Bureau of Canada: Mr. Chairman, honourable senators, the brief of the Insurance Bureau of Canada is primarily technical. Insurance is an industry which is of such a special or different nature that its financial structure and its day to day operations are governed by federal and provincial legislation, and supervised by federal and provincial officials. The reader of the Insurance Bureau of Canada brief will probably note there is a distinct conflict between the ways and means whereby an insurance organization must operate under the special laws governing our industry and the philosophy set forth in the White Paper. For these reasons, the Insurance Bureau of Canada felt the members of this committee of the Senate could obtain the best possible information and answers to questions from our senior tax consultant, Mr. David Atkins, an Oxford Master of Arts, a chartered accountant, and a partner of McDonald Currie and Company. Mr. Atkins is sitting to my right.

A summary of our brief has been prepared and is incorporated at the front of the brief. In Part I, general comment is offered on the philosophy of some of the major suggestions in the White Paper, all based on the assumption of the stated goals and standards of the Paper. In particular, the non-life insurers declare their belief that to tax unrealized gains on share in widely held corporations is not equitable and will not enable the government to attain its objectives. The suggestion would tend to limit the growth of such companies, and further may lead to the gradual erosion of their Canadian ownership. The provisions especially affecting non-residents appear to run contrary to established practice of international tax treaties.

The brief comments on the proposal to increase tax rates on personal incomes over \$10,000 per annum, and states that because the rates of tax are so much higher in Canada than elsewhere, when coupled with other types of taxes, this is likely to affect adversely the supply of skills and ability so necessary to ensure the future growth of the economy of Canada.

Part 2 of the brief deals solely with problems resulting from the White Paper proposals as they affect the non-life insurance business in Canada. It should be recognized that insurance is properly regarded as essential to industry and commerce and without the facilities it provides, investment in the development of natural resources and of secondary industries would inevitably be curtailed. Because the existence of an adequate insurance market is necessary, the solvency of an insurer is of special importance and the rules developed by the Departments of Insurance in Canada and the provinces are designed to this end. For this reason, the pattern for establishing reserves is of a special nature and accounting methods differ from those of other businesses.

The corporate structure of an insurance group in this country has been built on foundations peculiar to the business which, because of reinsurance, is of an international nature.

Part 3 of the brief deals with the effect of White Paper proposals on the insured who is indemnified under his insurance contract. It also deals with the establishment of the value of property to be insured. In the light of co-insurance conditions contained in many policies this is of vital importance.

The brief also demonstrates the effect of deemed realization of the assets of an individual at the time he gives up his Canadian residence. This is of special importance to an employee of an insurer bearing in mind the international nature of the operations of so many of them and the consequent movement of staff.

The brief protests the suggestion of taxing agents and adjusters on an accrual basis. People engaged in these correlated insurance fields work as separate contractors. Nevertheless, insurers and agents and adjusters are interdependent and insurers feel that the proposed tax method may affect significantly the supply of such essential services in the future.

The Chairman: Honourable senators, there are two things I want to say. One is that we must finish this hearing; the other is that I have to vacate the chair for a short time. Senator Haig has agreed to take over. I want to start things going by asking your expert this

question. From the point of view of the Insurance Bureau, if you were asked to pick out a single major problem which the proposals in the White Paper would put on this particular operation, non-life insurance, what would you say and tell us why.

Senator J. Campbell Haig (*Acting Chairman*), in the Chair.

Mr. D. Atkins, Insurance Bureau of Canada: I think it is the question of what the White Paper has not done rather than what it has done.

The Acting Chairman: It is pretty difficult to talk about what it has not done, but you go ahead and try.

Mr. Atkins: I think this is connected with the broadening of the bases for recognizing income. There are two factors involved here. First, it is consolidation of accounts for tax return purposes among related companies. Secondly, and more importantly perhaps, is the recognition of losses for a term longer than one year back and forward five. I think the loss position is extremely important in so far as foreign casualty insurers are concerned.

The Acting Chairman: Are there any questions by honourable members?

Senator Molson: What is the change in that respect?

Mr. Atkins: There is no change.

Senator Molson: This is one of the things that it has not done?

Mr. Atkins: That is right.

Senator Molson: You would prefer to see those carried forward and back to what extent?

Mr. Atkins: I think we recommend carrying back five and forward ten. The Royal Commission on Taxation recommended that losses be carried forward indefinitely. We made the suggestion as to ten years forward because we felt that any longer period would impose an administrative burden on the appropriate authorities. We also found that insurance profits and losses appear to move in cycles of anywhere between five and seven years and that therefore the broadening of the term of application of losses would offset this particular effect.

The Acting Chairman: Are there any further questions?

Mr. Piper: That is dealt with on page 6.

Senator Molson: May we ask what the next serious implication would be?

Mr. Piper: I would like to bring to your attention one technical point. By law, under the Insurance Act, we are only allowed to distribute—this can be found on page 12 under the heading of dividends—75 per cent of the average annual profits of the company for the three preceding calendar years.

If the White Paper proposal is implemented, then, of course, I presume the Insurance Act would have to be changed. The tax legislation would have to be amended to bring it into line with the Insurance Act, because at the moment, the two are in obvious conflict.

Senator Molson: Mr. Chairman, many of the points which are brought out in the brief in more general terms are those which we have discussed a good many times and they seem to reinforce what has already been said. I think that is why we are not asking more questions.

The unrealized gains referred to on page 2 is one item that we have had expressed so often in Committee that our chairman usually says we do not want to get into that discussion.

Senator Burchill: Are you in favour of a capital gains tax for Canada?

Mr. Atkins: I have to speak for the committee of the Insurance Bureau of Canada, which discussed this very point. As far as unrealized gains are concerned, of course the bureau rejected that concept. Generally speaking it is felt that some form of taxation should be levied on capital gains. This was not studied in any greater depth.

The matter was raised about integration between estate taxes and capital gains. This is such a complex subject that it has undergone a great deal of study in the United States. We thought we would put that one aside and leave the matter there.

Senator Burchill: Have you considered how we should approach capital gains here in Canada? For instance, do you think capital gains should be confined to certain things or should it be wide open?

Mr. Atkins: I think that if one accepts the concept of taxing capital gains one cannot pick and choose among various types of assets, but as soon as you

impose economic considerations then, of course, one must be more pragmatic and select items. But, as I say, we have not studied this particular aspect at all.

Senator Phillips (Rigaud): There is one question I would like to put. We have been considering the desirability of recommending the elimination of the withholding tax on foreign investors who lend money to Canadians, so that a distinction will be drawn between a withholding tax of, say, 15 per cent for the U.S. applicable to dividends as distinguished from interest payments made to non-residents. Do you think that the lending activities of the life companies in Canada would be affected from the point of view of their placing their money in Canada on loan if such benefit were given to non-resident lenders?

The Acting Chairman: I would remind you that we are dealing with the non-life insurance companies.

Senator Phillips (Rigaud): I am sorry. I apologize.

Senator Molson: The second point made on page 2 is the increase in rates levelled at skilled individuals whose incomes are generally over \$10,000 a year, and you develop that further on page 3. You feel very strongly, I gather, that the impact of the increases in tax on those groups—that is to say, the groups with incomes of \$8,000 to \$24,000 per year—is going to have a highly undesirable and quite serious effect on the overall economy, perhaps in the form of a brain drain or other forms. Is this correct?

Mr. Atkins: Yes, that is correct. I think also there is some social commentary in the White Paper on the increase in rates at that level, and we wondered what particular studies the Government had made that let them to draw these particular conclusions, namely, that there would not be a loss of skills to Canada. We would like to know more about these studies.

Certainly in the insurance industry which, as we have stated, is international, where personnel move from one country to another, it is important that skilled personnel, particularly those at those income levels, are attracted to Canada.

Mr. Piper: It is rather significant, senator, that we have only three or four casualty actuaries in the whole of Canada.

Senator Molson: We had a discussion this morning—and we have had the same discussion at nearly every meeting of the committee—about the effect of this

impact on some people in those groups, and the amount of money involved.

Mr. Piper: Of course, speaking as an individual rather than as a representative of the Insurance Bureau of Canada, I can see in my own family relations how youngsters coming out of college are looking around the world. They are not thinking automatically of taking up a business or professional career in Canada; they are looking quite frankly around the world.

Senator Molson: On our record is a comparison between the individual rates in Canada and those in the United States, and it shows a very unfavourable comparison in those middle brackets. You may or may not have seen that in our proceedings, but it has been raised on previous occasions, and it is considered to be quite serious.

The Acting Chairman: Especially when dealing with international companies.

Mr. Piper: I have a younger brother who is a very competent engineer in Los Angeles. He lives there at about double the scale that I can in Canada on approximately the same income.

Senator Carter: You have 193 companies in your membership. How many of those are all-Canadian companies?

Mr. Piper: I could not tell you offhand, sir. I can file that information with the committee.

Senator Carter: Roughly, what would be the proportion?

Mr. Piper: It is approximately one-third Canadian, one-third American, and one-third British and other foreign companies.

Senator Carter: And you reinsure your risks outside of Canada?

Mr. Piper: Well, some companies do and some companies do not.

Senator Carter: In the case of companies which do, how are they affected by the White Paper proposals?

Mr. Atkins: The quick answer to that is that I do not know that companies which reinsure across the border are affected in any way, but there is a problem connected with this and it involves the regulations and

the law governing insurance companies, whereby reinsurance of this nature does not serve to reduce the liabilities of the direct writing company in Canada. So, no matter how much a company situated in Canada may reinsure outside Canada, for regulatory purposes its liabilities remain the same, and the authorities ignore this factor. As risks become greater—and, as, indeed they are—the factor of reinsurance placed outside of Canada is going to become more important.

The effect of tax on all this is, of course, that a company in Canada is obliged by law to maintain assets, which are mainly investments, at least equivalent to the extent of its legal liabilities in Canada.

Senator Carter: And your dividends are controlled?

Mr. Atkins: Yes, and the dividends are controlled. This thing is highly regulated. As a backdrop to the White Paper I would say that we have three things, namely, the nature of the insurance business itself, which is international; secondly, the regulations governing the insurance industry; and, thirdly, the recent amendments made to the Income Tax Act which affect insurance. These three things are at times in conflict with the concepts of the White Paper. There is not a very happy marriage between those three items and what is proposed in the White Paper, and, of course, a lot of the bureau's brief concerns the friction occasioned by those three elements working against the White Paper.

The Acting Chairman: Are there any other questions?

Senator Phillips (Rigaud): Mr. Chairman, as you know, in this committee we have taken the position that the likelihood is that we are against the whole concept of integration in the White Paper, and that is why we direct ourselves, as we listen to representations, to certain items that may be related to the peculiar problems of the industry that is before us at a given moment. I came in late on account of having other commitments but I am wondering if you have specifically mentioned—I do not want a repetition, but are there any particular problems affecting the casualty and fire companies that have not been dealt with before this committee.

Mr. Atkins: Yes, we have touched on that, but I would like to elaborate for a moment or two, if I may, Mr. Chairman . . .

Senator Phillips (Rigaud): I would think that is the part of your brief that we are most interested in. As Senator Molson said earlier, the failure to discuss with you the five-year revaluation and capital gains, and so on, is due to the fact that we have already exhausted that subject. It has been dealt with at length in a hundred briefs, and there may well be more. I think the chairman will agree that we are more concerned, as we listen to further briefs, with being seized with particular problems that affect your companies.

Mr. Atkins: Senator, there are two important points that we have touched upon. First of all, this involves a question of insurance law. Under insurance law a Canadian insurance company, and, indeed, a branch of a non-resident insurer, must maintain assets equal to its liabilities. Of course, these terms "assets" and "liabilities" are not accounting terms; they are legal terms, and they are defined in the insurance laws. Now, the interaction of integration—in other words, the flow of income through to the shareholder—becomes extremely muddled when compared with these insurance laws. First of all, it is extremely difficult to free funds to move to the shareholders, even though the insuring entity has made a profit, because the requirements regarding solvency are extremely conservative. That is the first point.

Secondly, in so far as a Canadian insurance company is concerned—and we have touched on this—it may only declare dividends or pay dividends, stock or cash, up to an amount of 75 per cent of its average profits in the preceding three years. Obviously, we are here in conflict with the two-and-a-year rule in the White Paper regarding integration, in respect of the flow-through of income to the shareholder. Indeed, the shareholder will never receive the full amount of income generated by the insurance company until that nature occurs. So, there is a definite friction occurring here between insurance law and the proposals contained in the White Paper.

Senator Phillips (Rigaud): But if the integration system is abandoned then you have no problem.

Mr. Atkins: Then I would think those two problems are overcome, yes.

Senator Carter: Are there any proposals in the White Paper that would tend to increase the take-over of Canadian companies by foreign companies?

Mr. Adams: If I may answer in this way, senator, I think there are certain factors contained in the White

Paper which would prevent Canadian branches of non-resident insurers from becoming domestic companies. Putting it another way, it has the natural effect of unrealized gains which naturally would erode Canadian ownership of Canadian companies. My feeling is that it would be a good thing if Canadians could have a greater share in this particular industry. Unfortunately, due to existing tax laws—and there is no mention in the White Paper of any change to this particular section of the tax laws—it is going to be very difficult for a Canadian branch of a non-resident insurer to become a domestic company. I think that is a great shame.

Senator Phillips (Rigaud): Would you repeat that? You say that the implementation of the White Paper would make it impossible for a branch of a non-resident parent to comply with the provisions?

Mr. Adams: What I am saying, senator, is that the existing tax laws make it punitive, from a taxation standpoint, for that branch to become a Canadian identity, and the White Paper has done nothing to alleviate that particular situation. If you like, I can get a little bit more technical here. From a taxation standpoint Canadian branches of non-resident insurers are now treated very much in the same way as resident Canadian companies. The branch is isolated and taxed as an identity. But, due to the revisions basically to section 110(b), which is the branch profits tax section of the Income Tax Act, were that Canadian branch to convert into a Canadian company there would be a deemed distribution or movement of funds back to the home office and a tax on that deemed remittance of funds to the home office, even though the underlying fund remained in Canada and was employed toward setting up the new Canadian corporation.

Senator Phillips (Rigaud): Because you, in effect, distributed your surplus back to the parent.

Mr. Adams: That is the theory though, in fact, the underlying funds would not have moved at all. I think this is a shame. Something should be done to remedy the situation.

Senator Phillips (Rigaud): What you are saying is that the White Paper does not deal with the current problem?

Mr. Adams: That is right. It certainly does not encourage the formation of Canadian corporations to replace foreign branches.

Senator Phillips (Rigaud): How much difference does that make if you have an industrial establishment of a foreign company and you are subject to tax in respect to your profits as distinguished from a Canadian company whose shares are owned by the foreign parent?

Mr. Adams: It brings it completely under Canadian control.

Senator Phillips (Rigaud): You will only get the Canadian control later, if you sell part of the shares to the Canadian public. The mere transfer of branch assets to a Canadian foreign company simply means the shares of the Canadian foreign company would at that stage be owned by the non-resident parent. It is only later that you provided the machinery.

Mr. Adams: Yes, you are quite right. This is the first step along the road. That step has to be taken.

Senator Phillips (Rigaud): You create the vehicle for ultimate Canadian participation.

Senator Aseltine: What is your real complaint with respect to the provisions of the White Paper for tax reform?

Mr. Adams: I think if I were to say one thing, it has done nothing to alleviate present severe problems.

Senator Aseltine: Problems that you have?

Mr. Adams: That we have.

Senator Carter: What has it done to make it worse?

Mr. Adams: These problems are niggling, I think, as they affect the industry. It is a question of foreign source income, the net receipt which is extremely lumpy. There is the question of integration which we have discussed and the position of maintaining solvency of the Canadian insurer and the restrictions to dividends. These problems are highly technical and one would say picayune, but unless they are cured they will become larger problems. Something has to give, either on the insurance law side or on the . . .

Senator Phillips (Rigaud): What you are really saying is whether under the present system or whether under the proposed White Paper system, the problems of taxation on profits is one thing, but you must take into consideration the peculiar nature of your business, the reserves required, the statutory provi-

sions under our act for the protection of the policyholders, and all the rest create a situation where you cannot follow ordinary corporate procedure applicable to ordinary business.

Mr. Adams: That is exactly it. We are asking for what a normal corporation is allowed and merely that laws are not in conflict; that there is a marriage of these laws.

Senator Carter: If I understand you correctly, what you have been saying is that the White Paper does not do anything to correct the problems you have in the present system and you do not see how you can mix the two if these changes are made one way or the other.

Mr. Adams: That is right. It merely aggravates a situation that is already bad.

Senator Phillips (Rigaud): Your point is that if there is going to be a revision of the entire system, this is the time to draw the attention of the legislators to that point.

The Chairman: Mr. Adams or Mr. Piper, have you anything further to add?

Mr. Adams: I know that your staff has noted it in our brief, but one of the points which did come to our attention right off the bat is that, in so far as the public is concerned, the person who buys property insurance is going to be taxed on the proceeds of his policy unless he replaces the lost or damaged property within a one-year period, which is very short. I was on the board of managers of a church that burned down in Montreal. It took us about two and a half years to build a new church because of building by-laws and the necessity of getting approval from various authorities. Now, had the White Paper proposals been in effect during that period we would have lost all our money. The insurance proceeds would have been taxed.

Senator Phillips (Rigaud): You are speaking of the extent of the profits. It is forced realization.

Mr. Adams: Well, they propose to exempt from taxable income the proceeds from forced realization under an insurance policy.

Senator Phillips (Rigaud): In relationship to the capital gains tax.

Mr. Adams: If these proceeds are used to purchase replacement property within one year, I think that the one-year provision is grossly inadequate. If you have a work of art, for instance, you are not going to be able to replace it in one year. It would probably take two or three years to find an equivalent replacement.

Mr. Atkins: There is one additional small point as it affects the insured that I would like to mention. That is the case of an insured who has under-insured, and his house is burned down or he loses some personal belongings. Of course, this is a capital loss and can only be applied against income of a similar nature. I find it hard to visualize how the taxpayer or the

insurer is to obtain income of this nature against which he may apply a loss of this kind.

Senator Aseltine: There is no remedy for that.

Mr. Atkins: Unless he puts up a stall in the street and tries to sell the rest of his personal belongings, I cannot see how he can ever obtain any kind of relief.

The Acting Chairman: Are there any further question? Thank you very much.

Mr. Piper: Thank you, sir.

The committee adjourned.

APPENDIX "A"

SUBMISSION ON PROPOSALS FOR TAX REFORM

TO THE

STANDING SENATE COMMITTEE

ON

BANKING, TRADE AND COMMERCE

BY

THE CANADIAN BANKERS' ASSOCIATION

P.O. Box 282,
Toronto Dominion Centre,
Toronto 111, Ontario.

May 15, 1970

The Brief in Summary

Introduction

The Canadian Bankers' Association commends the Government of Canada for giving the public an opportunity to discuss its major proposals for reform of the income tax structure. It also wishes to express its appreciation to the Committee for the very onerous task it has assumed in considering the detailed representations on the White Paper.

The following is a brief summary of the points made in our submission.

1. Aims of Tax Reform and Total Tax Burden

01. Although the proposals for tax reform are put forward to achieve a better and more acceptable tax structure, it is our view that these essential objectives are being adversely affected by proposals which would collect substantial additional taxes and increase the total tax burden. This burden will be particularly onerous on the income groups whose work and investment is crucial to the overall economic well-being of Canada. In addition, the proposals appear to contemplate a substantial shift of the gross national product from the private to the public sector. It is our view that the implementation of the proposals would result in the inhibiting of incentives to work and save and the curtailment of economic growth.

02. The government should establish a specific program of gradual reductions to the personal income tax schedule over the five-year transition period to offset the substantial additional revenues which will accrue from the combined effects of inflation, economic growth and the progressive tax schedule.

2. The Individual and Family in Tax Reform

01. We support the proposal that the tax burden on the low income earner be reduced.

02. The proposed re-structuring of rates, coupled with the inclusion of capital gains in taxable income, results in an undue shift of tax burden to the taxpayers in the \$9,000 - \$16,000 income range. This will reduce savings, investment and work incentives in this very crucial segment of the population.

03. We propose that the top rate of 50 per cent be imposed at a higher level than \$24,000 and that lower brackets be broadened accordingly. The planned reduction in tax rates, which we have proposed be made over the five-year transition period, should be concentrated in the personal income tax field.

04. The absence of proposals relating to benefit and contribution limits of pension plans is noted and concern expressed for the

character of the ultimate proposals. The proposed limitation of 10 per cent on the proportion of a pension fund's total assets which may be invested in foreign assets would be unduly restrictive because some important growth stocks would no longer be eligible investments and would also be inadequate for those companies with international operations since a part of the liabilities of their pension funds are payable in foreign currencies. The proposal that pensions paid from Canada to persons living abroad be subject to a 25 per cent withholding tax could create real inequities and hardships.

05. The proposed income averaging provision is unsatisfactory and we recommend the extension of some existing methods to cover all cases.

06. We commend the deduction of employment expenses and recommend a carry-forward of undeducted moving expenses.

3. Capital Gains

01. Recognizing that there are arguments both for and against a capital gains tax, we believe that the utmost caution should be exercised in the introduction of a capital gains tax in Canada. Even if the case in equity is made convincingly, it must be carefully assessed

against the questions of economic effects, particularly on the flow of savings and investment and on the related qualities of enterprise and initiative which Canada so greatly needs to ensure the dynamic growth of its economy.

02. We believe that there are a number of points which require to be given the most serious thought in the consideration of this type of tax:

- (a) The tax should be at rates not higher than in the United States or the United Kingdom.
- (b) While the present practice should be continued for gains resulting from the carrying on of a business, all other realized gains, unless they are specifically exempted, should be taxed at not more than half the rates on ordinary income and certainly not in excess of a maximum rate of 25 per cent.
- (c) Any capital gains to be taxed should be taxed only when realized; the five-year deemed realization proposal should be dropped.
- (d) The capital gains of non-residents should not be taxed whether realized or not realized. The levying of a capital gains tax on non-residents would inhibit foreign investment in Canada.
- (e) Residents of Canada who change country of residence

only temporarily to facilitate their employer's operations should at least be allowed to defer payment of any capital gains tax.

- (f) There should be a complete exemption from tax for a taxpayer's principal residence and for other property held for personal use or enjoyment.
- (g) If a capital gains tax is introduced, arrangements should be made for an eventual integration of this tax with the system of estate and gift taxation, leading to the eventual substantial reduction, if not elimination, of estate and gift taxes.

4. Corporations and Their Shareholders

01. We propose that no distinction be made between corporations as closely-held and widely-held.

02. We propose that in place of the integration system set out in the White Paper the existing dividend tax credit system be retained, with certain modifications.

03. We believe that the government should continue a program of incentives to foster the expansion of small business. Possible substitutes for the present dual rate would be accelerated capital cost allowances, an investment tax credit or an investment reserve, to be used either jointly or as alternatives.

04. Until such incentives are introduced the dual rate of taxation should be continued, although consideration might well be given to restricting the dual rate to small incorporated businesses instead of permitting it for all corporations.

5. Business and Property Income

01. We approve the recognition the White Paper gives to certain business expenses which have not hitherto been allowed as deductible from taxable income - the "nothings".

02. We propose that businesses should be allowed to deduct reasonable expenses for entertainment, costs of attending or sending employees to conventions, and costs of membership dues in social or educational clubs.

03. We urge that future policy on capital cost allowance rates be made known as soon as possible to remove any unnecessary uncertainty for the business community.

04. We urge that charitable donations be treated as an expense made in the ordinary course of business.

6. International Income

01. In general we approve the stated objectives of seeking

neither to discourage non-residents from investing or carrying on business in Canada nor to discourage Canadians from investing or carrying on business abroad. We agree with the philosophy of preventing abuses and closing loopholes, but question whether the relatively small amount of revenue to be obtained will justify the disturbance of bona fide business operations. In addition, we completely support the proposals to expand and improve our network of reciprocal tax treaties.

02. In many particular respects, however, the White Paper proposals raise obstacles or difficulties for companies such as the banks which have important international operations. To avoid some of these difficulties, we recommend specifically that:

(a) the Canadian tax credit provision abandon the per country system and allow averaging as in the United States.

(b) a tax credit be allowed for taxes paid on income in all foreign countries, including those other than the one in which the foreign branch or foreign subsidiary is located, and taxes paid by a subsidiary of the foreign subsidiary.

(c) any statutory definition of passive income should draw a distinction between financial institutions and investors, as is the case under the United States tax provisions.

(d) Canada should allow the benefit of incentives granted by many young countries to be effectively carried through to Canadian tax liability.

(e) in its new tax treaties Canada should distinguish between interest paid on commercial lending and interest paid on investments to ensure that the former is treated in the same way as "industrial and commercial profits".

(f) tax treaties should provide for a treaty tribunal to settle disputes and problems of double taxation arising under the treaty.

PART I

AIMS OF TAX REFORM AND TOTAL TAX BURDEN

1. In modern societies such as ours, tax systems are designed to achieve three objectives. One, obviously, is to provide the revenues necessary to pay for the services required of government by the people; another is to act as a vehicle of social policy; and a third is to serve as an instrument of economic policy.

2. The process by which government determines what the community wants, or needs, by way of government services is of great concern to all Canadians, particularly if the result of this process is an attempt to provide government services which can only be supported at the cost of economic strain or by interference with the most efficient and productive allocation of resources. A similar comment is relevant with respect to taxation as an instrument of social policy.

While our Association recognizes fully the importance of these issues, we shall, nevertheless, concentrate in this brief on the potential economic effects of the proposals for tax reform.

3. The economic implications of taxation are of direct concern to this Association, because the banks, involved as they are throughout the country as financial intermediaries in almost every facet of economic life, naturally are interested in measures affecting their millions of customers, hundreds of thousands of shareholders and employees and, more broadly, the economic health of Canada.

4. We fully approve of the aims of tax reform as set out in paragraph 1.6 of the White Paper. However, a number of questions arise in the consideration of these objectives in relation to the proposed means of achieving them, and also in relation to their total effect on the tax burden of Canadians.

5. In our view, the essential objective of the White Paper - that is, the attainment of a better and more generally acceptable tax structure - has become substantially overshadowed by the built-in addition to the total tax burden involved in the various proposals.

6. On a static type of projection, based on 1969 incomes, the White Paper estimates that the proposed system would, after a five-year run-in period, add \$630 million to government revenues. Other projections on a similar basis have shown substantially higher figures. If on top of these static estimates, reasonable allowance is made for economic growth, inflation and the progressive nature of the tax schedule, it is clear that the addition to revenue in the fifth year would be substantially greater than \$630 million.

7. The obvious implication is that a continually increasing proportion of national production will be channelled through the

government sector. The White Paper does not explicitly make a case for any such result. Indeed, it skips over the fact that even the current level of taxation (which is the starting point for its calculations) includes a supposedly temporary three per cent surtax levied for the specific purpose of providing an anti-inflationary budget surplus. This surtax, which was originally scheduled to end at the end of 1970, is now included among the various levies to be swept up into the proposed new basic rate structure. We think that in any realistic appraisal of the revenue effects of the proposals, as compared with the present system, this surtax must be considered as an element of added tax.

8. The question of additional tax revenue is of crucial importance, for it is the marginal addition to tax levies or tax rates which most influences one's judgment on the economic ramifications of proposed changes. In essence the White Paper argues that it was necessary to ensure that no loss of revenue occurred in the first year of the new system, and that the general build-up of added revenues in the subsequent four years could be dealt with as it arose. If this is so intended and planned, then the government should establish a specific schedule of gradual tax reductions over the five-year transition period as a rough counter-weight to the estimated gradual build-up of new revenue flows. Our suggestion in this regard would be to apply these reductions

in the area of the personal income tax (as elaborated upon in Part 2) .

9. In our view, the basic points at issue are, first, the extent to which the indicated addition to government revenue confuses the issues in the whole consideration of the proposed structural changes; secondly, the shift from the private sector to the public sector of an increasing proportion of gross national product; and thirdly, the imposition of the increased tax burden mainly on the income group whose work and investment is crucial to the overall economic well-being of Canada. These issues are most important in giving consideration to the changes proposed in the White Paper. It is our view that the substantial additions to government revenues, the imposition of the increased tax burden on the middle income groups and the reduction in savings in the private sector will have an inhibiting effect on incentives to work and save and will curtail economic growth.

PART 2

THE INDIVIDUAL AND FAMILY IN TAX REFORMRate Schedule and the Tax Burden

10. Undoubtedly one of the most important questions raised as a result of the proposed addition to tax revenues is in the area of the personal income tax. With the avowed aim of relieving the tax burden on lower-income groups, it is proposed to raise the basic exemptions provided not only to this group but to all taxpayers. On the basis of the White Paper projection, this change would reduce revenues by about \$1 billion -- a reduction taking effect in the first year and remaining unchanged in subsequent years. Of this revenue cut, however, only about \$35 million would go to exempt taxpayers in the low-income groups, with the remainder accruing to all other taxpayers. And this in turn would be more than offset by the proposed adjustments in the rate schedule and the introduction of a capital gains tax. As a result of the proposed pattern of rate adjustments, moreover, a narrowing -- or "concertina-effect" -- would take place in the gradation of the rate schedule.

11. While the government is to be commended for proposing to re-model the current heterogenous tax schedule into a new set of rates, the result is by no means ideal. To contract the rate structure as proposed would mean that taxpayers in the \$9,000 - \$16,000 income

range would be called upon to bear the major portion of the new tax burden. Furthermore, the inclusion of capital gains in taxable income would aggravate the tax burden of this group.

12. This added weight of taxation could not help having a dampening effect on incentives to initiative, effort and investment in Canada.

From this point of view, we believe there should be a less compressed range of rates, with the top rate being reached at a higher level than the proposed \$24,000. In any event, the net tax burden in Canada should be generally comparable to that in effect in other countries - particularly in the United States.

13. We suggest that the combination of personal tax changes be applied in such a way as to yield the indicated revenue in the first year of operation, but that tax revenues from personal income taxes in subsequent years be gradually reduced to offset increased revenues which will flow, first, from the combined effects of inflation, economic growth and progressive tax schedules, and secondly, from any of the other proposals for tax reform which, if implemented, would give rise to additional revenues.

14. Probably the simplest way to secure such a result would be to reduce the schedule of income tax rates at the beginning of the adjustment period and to institute a concurrent surtax fully applicable in the

first year, but diminishing gradually to zero in the fifth year.

Pension Plans

15. The Minister of Finance has stated that although he is not satisfied with existing pension fund guidelines, no change is contemplated at this time. We are concerned since pension fund planning essentially comprises long range programs and the present position of uncertainty will make it extremely difficult to formulate policy with any degree of assurance. In addition, several recommendations of a technical nature have been included in the tax proposals for immediate action. In our opinion, these require clarification and, in some cases, revision.

A. Limitation on Foreign Assets

(a) The proposal in respect of the 10 per cent limitation on foreign assets in registered pension plans represents a major departure from existing qualifying requirements. It is not indicated whether calculation would be made on cost, book or market value. We assume that the answer is amortized cost, otherwise a fund which was close to exceeding the limit would be placed in a difficult position if the value of foreign holdings went up and/or the value of Canadian securities declined.

(b) The first responsibility of pension funds is to those who entrust retirement funds to their administrators. Having in mind that

some important growth stocks would not be eligible, we believe a 10 per cent ceiling on foreign assets would be unduly restrictive and we propose that this limitation be increased to not less than 20 per cent.

(c) The White Paper has not indicated whether the 10 per cent rule is to apply to the investment of new funds or to total assets. If it is intended to apply a percentage limit to all assets, a transition period of not less than five years would be required so that an orderly restructuring of assets could be achieved.

(d) Many companies with international operations accept pension fund contributions from non-Canadian employees and due allowance for the foreign currency pension liabilities relating to such employees should be made in considering the permissible proportion of total assets which may be invested in foreign securities or other foreign investments. In this regard, it must be kept in mind that foreign governments might in fact insist upon local investment. We recommend, therefore, that if a limit is established on foreign investments it should be in addition to the percentage that foreign liabilities bear to total liabilities of the fund. This principle is recognized in the Pension Benefits Standards Act - Schedule C Investments Regulations, Section 1 (a) (iv).

B. Withholding Tax

(a) The White Paper proposes that pensions paid from Canada to persons living abroad be subject to a 25 per cent withholding tax or "lower or higher rates if the circumstances of the recipient warrant". By taking this action Canada would not only place those persons receiving pensions outside Canada in an unenviable position, but would also seem to reject the OECD treaty concept in this regard. If double taxation is to be avoided many tax treaties will have to be amended in order to avoid penalizing non-resident pensioners.

(b) Apart from the lack of protection in existing treaties, there are two areas where any proposal to withhold tax on pensions paid to non-residents would cause inequities or hardship:

(i) Retired employees who have contributed to a pension fund from their earnings arising outside Canada. It seems totally inequitable that a retired employee of a Canadian firm having international operations who may never have been employed in Canada should find his pension payments, which have their source in Canada, subject to a Canadian withholding tax. Such persons should be exempt. To withhold under these circumstances would place Canadian employers of foreign personnel at

a competitive disadvantage vis-à-vis domestic employers. Provisions should also be made for other special circumstances, e.g. Canadians who spend part of their careers working abroad and retire outside Canada.

(ii) People already retired and living abroad to whom no retroactivity should apply.

16. It should be borne in mind that portions of pensions relating to contributions made between 1927 and 1945 are tax free.

17. The requirement that the trustees of a plan be made liable and responsible for any taxes arising out of the operation of a pension plan seems to place an unfair responsibility on the trustees. If, in fact, there have been abuses in this area they should be dealt with through reasonable regulations and inspection procedures.

18. The intent of the proposals relating to benefit and contribution limits for pension plans is of utmost importance and should be clarified.

Income Averaging Provisions

19. While we are in agreement with the concept that all taxpayers should have the opportunity to average income where it is subject to

wide fluctuations, rather than a restricted number of taxpayers as at present, we do not believe that the proposals as outlined will afford any real degree of relief. As the proposed averaging provisions are non-operative where the average income, after personal exemptions, is over \$18,000 per year, the application of the option becomes very limited. When considered in the light of inflationary trends this limitation becomes even more pronounced.

20. We suggest that there is little need to look beyond the existing legislation for equitable averaging provisions. Section 36 has been used widely under specific circumstances, and its value has been proven. We recommend therefore that in lieu of adding complex new legislation to deal with income averaging, the present Sections 35 and 36 should be extended to cover all situations relating to wide fluctuations in income. Unless a solution of this nature is reached, holders of savings instruments which combine capital and income elements could be adversely affected. We believe that the present provisions offer sufficient scope to cover the broad range of existing averaging situations.

Employment Expenses

21. Current legislation denies to a large extent the right of a taxpayer to deduct expenses incurred in earning wages and salaries,

whereas those who carry on a business or profession have been able to deduct such expenses in determining the taxable position. The government is to be commended for recognizing this anomaly, and although the proposed general deductions are not as large as those in effect in the United States, we believe that this is a step in the right direction. We recommend that the limit of \$150 be subject to frequent review in order to maintain the deduction at a realistic level.

22. The deduction of moving expenses arising from a change of employment seems to produce a number of problems. Since such expenses only can be deducted from income earned in the new job the taxpayer who moves at year-end should be granted the opportunity to carry forward these expenses until the following year. The precise meaning of a change of job should also be defined.

PART 3

CAPITAL GAINS

23. From all the study and debate on tax questions over the past several years, it should be clear that there are important arguments both for and against the introduction of a capital gains tax in Canada at this time. The White Paper, in proposing the introduction of such a tax, lays stress on the varied and unsatisfactory treatment of capital gains under the present system, and on arguments of equity which, it is said, require the inclusion of capital gains in income. On the other side, however, are the questions of economic effects, particularly on the flow of savings and investment, and on the related qualities of enterprise and initiative which Canada so greatly needs to ensure the dynamic growth of its economy. These are questions which should not be dismissed lightly.

24. In reflection of these pros and cons, and some of the technical intricacies involved, we believe that there are a number of points which should be given the most serious thought in the consideration of this type of tax.

(a) It would be unrealistic to consider a system in Canada involving higher rates than those in effect in other countries, such as the United States and Britain, which are more mature economically and with which we have close economic relations.

(b) For those capital gains secured as part of a regular business, taxation would continue at full income tax rates. But for all other realized capital gains that are not specifically exempted, we recommend that the rate of tax should not be more than half that on ordinary income and, in any event, not more than 25 per cent.

(c) The White Paper makes no mention of any related adjustment of gift and estate taxation. A major justification made for the current substantial estate tax rates has been that they provide an "income tax" on those additions to wealth which were not taxed previously. If such gains become taxable, arrangements should be made for an eventual integration of this tax with the system of estate and gift taxation, leading to the eventual substantial reduction if not elimination of estate and gift taxes.

(d) The proposal for a deemed realization of capital gains every 5 years on shareholdings in widely-held Canadian corporations is unrealistic and would have many undesirable results. For resident shareholders, such a levy could cause serious problems. Faced with a substantial increase in share value over his cost basis, a shareholder might be

forced to sell some shares in order to meet his tax liability. Alternatively, he might try to induce the corporation to pay cash dividends or redeem stock dividends paid in earlier years. Imposing such a tax would be particularly serious if the shares could not be readily marketed. For non-residents, meanwhile, it is a moot question as to whether Canada could induce other countries to accept the principle that the unrealized capital gains of non-residents be subject to tax. If such agreements are not possible, then resident Canadian shareholders would be treated more harshly than non-resident shareholders. Because of these considerations, we believe that taxation of capital gains should be on a realized basis only, with appropriate "roll-over" provisions to allow needed reorganizations of business entities. We do not believe, however, that even the realized capital gains of non-residents should be taxed. Apart from the fact that Canada cannot under its current tax treaties impose such a tax on non-residents, the levying of a capital gains tax on non-residents would inhibit foreign investment in Canada and the free flow of funds from other countries.

- (e) In connection with the proposals for a deemed realization of assets on ceasing to reside in Canada, we believe that a more flexible system should be developed. Residents of Canada who change country of residence only temporarily to facilitate their employers' operations should at least be allowed to defer payment of any capital gains tax.
- (f) In our view, it would be best to provide a complete exemption from tax of any capital gains registered on the sale or "roll-over" of a taxpayer's principal residence. Over and above the considerations outlined in the White Paper, there is a strong case, we believe, for allowing much greater leeway to persons who move from one house to another in connection with a change or transfer of job. In general, however, this problem and most of the administrative complexities in this whole area would be avoided by an overall exemption for a taxpayer's principal residence.

(g) For other property held for personal use or enjoyment, there are several grounds for suggesting a complete exemption from capital gains tax. If, however, the government were to tax gains from such items, the limit should be substantially higher than the proposed \$500.

PART 4

CORPORATIONS AND THEIR SHAREHOLDERSThe Question of Integration

25. The White Paper proposes a new system to integrate corporate and personal income tax structures by establishing a single rate of corporation tax and providing a system of credits to shareholders for corporate taxes paid. A distinction would be made between private, closely-held corporations and public, widely-held corporations both in relation to the flow of income between corporations and shareholders and in relation to the taxation of capital gains.

26. Our Association disagrees with the principle of making a distinction for tax purposes between different types of corporations, mainly because we doubt the practicality of achieving such a distinction, and also because of our suggestion to re-consider the proposals relating to integration and capital gains tax.

27. In addition to our views on the inadvisability of distinguishing between closely and widely-held corporations, our Association also questions the desirability of establishing a new system of integration whereby Canadian shareholders would obtain credit for income taxes paid by the corporation to replace the existing dividend tax credit system. Both systems (i.e. integration

as proposed by the government and the existing tax credits structure) have the same objective: to pass onto the Canadian shareholders the benefit of Canadian income tax paid by the corporation. We are concerned, however, with the administrative burden which the government's integration proposals would create.

28. As the White Paper states, the dividend tax credit "is a rough and ready method of offsetting corporate tax". It may well be desirable to make improvements in existing arrangements by providing for refunds where the dividend tax credit exceeds the taxpayers' tax liability, and possibly, by introducing a graduated scale of credits where the rate falls as income rises.

29. In summary, we believe that it would be preferable to maintain the existing dividend tax credit system with whatever modifications appear desirable, rather than change to the system of integration proposed in the White Paper. Indeed, it is our belief that, even if in theory the government proposal might appear more equitable, in practice the difficulties of administering the proposals would result in greater inequity than under the present tax credit procedure.

Small Businesses

30. A serious shortcoming in the White Paper, both from the standpoint of tax treatment and in the light of public reaction, lies in the proposed treatment of small businesses, whether incorporated or not.

31. There is no doubt that the dual rate of corporate tax has helped small corporations to accumulate capital to grow and to expand. We recognize also that this system extends benefits not only to the small corporations it is designed to help, but also to all other corporations.

32. The White Paper proposes to remove the existing lower rate of corporate tax over a period of five years, but fails to provide small businesses both incorporated and unincorporated, with alternative means of growth and encouragement.

33. The recent announcement by the Minister of Finance that the question of small businesses is under thorough study is welcome. Clearly, what is needed is a practical and effective means of fostering sound and enterprising expansion in this important sector of the economy.

34. In its exhaustive studies of this problem, the Royal Commission on Taxation concluded that the most promising means of fostering such development would be through a system of accelerated capital cost allowances for new capital expenditures by small businesses, both incorporated and unincorporated. We believe that much could be achieved through this approach, although real problems would remain in determining appropriate limits - in amounts and duration - for such concessions.

35. Other alternative approaches that might be considered are a form of investment tax credit, a form of investment reserve or a program of temporary tax deferment. Under the tax credit approach, businesses would be allowed, in addition to ordinary capital cost allowances, some deduction from their tax liability for specific amounts (and types) of capital expenditures. Under an investment reserve system, tax-free sums accumulated by businesses would be invested in appropriate ways within a specified period of time. We believe that it might also be desirable to introduce more than one alternative within appropriate limits to overcome the shortcomings of the suggested approaches. Such an overall program would have to be carefully designed and co-ordinated with all other methods of inducement to business expansion.

36. In conclusion, we firmly believe that it is desirable to establish a system of special incentives to foster the expansion of small businesses. If, however, the government does not introduce such alternative incentives, the existing dual rate system would seem to be satisfactory, although consideration might well be given to restricting these provisions to small incorporated businesses instead of permitting them for all corporations.

PART 5

BUSINESS AND PROPERTY INCOME

37. The White Paper points out that a profit determined in accordance with normal commercial and accounting principles is the basis for computation of taxable income from a business or property, but that particular rules have been introduced by law and practice in certain circumstances even though they differ from those in commercial use. The White Paper states further that this general system has worked well and radical changes are not proposed. We largely agree with this thesis, but we think that the statutory rules and Department of National Revenue practices require updating.

The "Nothings"

38. We commend the proposal made in paragraphs 5.4 through 5.8 of the White Paper that deductions from income hitherto denied should be allowed for certain expenditures. These are the so-called "Nothings". Specific mention is made of goodwill, but we assume that these proposals would also apply to payments for cancellation of contracts which are not now clearly deductible; to payments such as options and architects' fees on projects which are proposed but not consummated; and to other similar outlays.

Entertainment and Related Expenses

39. We do not accept as reasonable the proposal that the Income Tax Act should specifically deny deduction of entertainment expenses, costs of attending or sending employees to conventions, and costs of membership dues in social or recreational clubs.

Reasonable expenditures of this nature are recognized not only by commercial businesses but by governments at all levels as part of the normal and necessary cost of their operations. Section 12 (2) of the Income Tax Act already protects the public revenue against losses from unreasonable charges against taxable income and we consider this provision to be adequate. We think that businesses should be allowed deductions for expenses judged necessary to generate income. We do, however, fully agree with the disallowance of expenses which can be shown to be unreasonable under Section 12 (2) of the Income Tax Act.

Depreciation

40. The White Paper states that the government intends in due course to review the system and rates of capital cost allowance. Accordingly, so as to enable taxpayers to make business decisions on a current basis, the government should give assurance that rates of capital cost allowances will not be reduced, either on existing

assets or on those for which commitments to purchase have been made.

41. We approve the proposal that a taxpayer be permitted at any time to write down a class of assets to the aggregate cost of the assets on hand. Clearly, this recognizes a present anomaly.

"Charitable" Donations by Business

42. An existing rule which we consider unrealistic is that which fails to recognize reasonable charitable contributions by business as deductions in the computation of business income. It is true that within specified limits donations to Canadian charities may be deducted from the taxable income of Canadian corporations, but this does not achieve the end that is presumably intended when the donor corporation carries on business in other countries. For example, if the corporation has a branch abroad, income from that branch will be brought into taxable income in Canada, but the donation which the branch makes to its local United Appeal will not be deductible.

43. The philosophy which recognizes contributions to Canadian welfare and education as ordinary, acceptable deductions from a corporation's income, should as readily accept as deductions similar contributions made by the corporation in the course of its business

in foreign countries. While under the Canada-U.S. tax treaty, donations to U.S. charitable organizations by a Canadian taxpayer doing business in the United States will have the same status of deductibility as those made to Canadian charitable organizations, there are no similar provisions with regard to such expenditures in other countries. Such expenses should not be disallowed, per se, as "charitable donations" but should be granted as deductions, except to the extent that they offend Section 12 (2) as not being an expense "reasonable in the circumstances". Essentially, we are stating the principle that Canadian corporations in business outside North America should not be penalized by Canadian tax authorities for accepting their recognized social responsibilities in foreign jurisdictions.

44. Further, and even more anomalous, a part of the corporation's contributions to Canadian approved charities will be effectively disallowed in Canada because Canadian tax authorities deem such contributions to have been made in part from income arising in the foreign branch operations. Removal of this inequity is not among the tax reforms proposed in the White Paper; we regard it as an omission which should be corrected. It does not appear to require amendment

either to statutes or regulations but only recognition within the Department of National Revenue that contributions made by business to charitable organizations are expenses made or incurred for the purpose of gaining or producing income from the business of the taxpayer, and only disallowable in the computation of income to the extent that the expense was not reasonable in the circumstances (Section 12 (2) of the Income Tax Act). We illustrate the point in detail as follows:

Contributions by business corporations to welfare and educational institutions are nowadays recognized by corporations as part of the normal cost of business and are accepted as such in management plans. That this view is shared by government is apparent from statements made from time to time in budget presentations. When the ceiling imposed on a corporation's charitable donation by Section 27 (1)(a) of the Income Tax Act was raised from 5 per cent to 10 per cent of taxable income, the then Minister of Finance said that a high level of private participation in the contributions to welfare and education was most desirable. He hoped that the amendment which he was then introducing

would swell the flow of funds from industry to the support of such causes. In practice, however, the Canadian taxpayer who has income which is taxed abroad as well as in Canada will find that not all of his seemingly eligible contributions to Canadian welfare and educational institutions are ruled deductible in determining the net Canadian tax payable.

In computing corporation tax in Canada at the present time, the Department of National Revenue views charitable donations as deductible from income in arriving at taxable income (Section 27 (1)(a)). It is by reference to income and not taxable income, however, that foreign tax deductions may be computed under Section 41. This means that nominally allowable donations to Canadian welfare and education are effectively disallowed in the calculation of the net Canadian tax payable. Take the example of a corporation with a taxable income of \$2,000,000 of which one-half is earned in foreign country A with a corporate tax rate of 50 per cent:

Country A tax on taxable income of \$1, 000, 000, 000 is (say)	50% of \$1, 000, 000		\$500, 000
Canadian tax on taxable income of \$2, 000, 000 is	21% of \$ 35, 000	\$ 7, 350	
plus	50% of \$1, 965, 000	\$982, 500	
	<u>\$2, 000, 000</u>	<u>\$989, 850</u>	
Effective rate is $\frac{\text{tax}}{\text{income}}$ = $\frac{989, 850}{2, 000, 000}$	= 49.4925%		
Foreign tax credit is 49.4925% of \$1, 000, 000		<u>494, 925</u>	<u>494, 925</u>
Aggregate tax			<u>\$994, 925</u>

If the same corporation donates \$200, 000 to

Canadian charities, its Canadian tax bill will

not be reduced by 50 per cent of \$200, 000 as was

surely intended by the legislators:

Country A tax on taxable income of \$1, 000, 000 is as before			\$500, 000
Canadian tax on taxable income of \$1, 800, 000 is	21% of \$ 35, 000	\$ 7, 350	
plus	50% of \$1, 765, 000	\$882, 500	
	<u>1, 800, 000</u>	<u>\$889, 850</u>	
Effective rate is $\frac{\text{tax}}{\text{income (not taxable income)}}$ =		$\frac{889, 850}{2, 000, 000}$	
	=	44.4925%	
Foreign tax credit is 44.4925% of \$1, 000, 000		<u>444, 925</u>	<u>444, 925</u>
Aggregate tax			<u>\$944, 925</u>

By contributing \$200,000 to Canadian charity the corporation reduces its tax bill by \$50,000, equivalent to only 25 per cent of the donation - not the 50 per cent to be expected and the amount by which the tax bill would have been reduced if the outlay had been, say, for advertising rather than for welfare contributions. This is an anomaly which should not be allowed to persist and we recommend that for income tax purposes charitable donations by a corporation should be treated as an expense in the computation of income rather than a deduction in the computation of taxable income.

PART 6

TAXING INTERNATIONAL INCOME

Background

45. All the chartered banks are involved in international transactions; indeed, several banks can properly describe themselves as international corporations. In general, they provide all kinds of international banking services in a great many countries and in many foreign currencies. The organization of these operations is, of course, varied and complex. Banks operate abroad through branches, and subsidiary companies owned wholly or partially. They also lend money to, and accept deposits from, residents of foreign countries in which no operating entities are maintained; they invest in foreign securities; and they own real property and other business assets abroad. All these operations are of direct assistance to the development of Canadian trade and business relations in other parts of the world and are of important indirect benefit to the whole Canadian economy. They are also subject to a wide variety of taxes and other imposts, and function profitably despite international currency, banking and other regulatory provisions which complicate and often hamper financial trading of this nature. It is against this background that the banks have been examining the international aspects of the government's tax proposals.

General Objectives

46. The White Paper asserts (in paragraphs 6.1 and 6.2) that Canada's existing tax system seeks neither to discourage non-residents from investing or carrying on business in Canada nor to discourage Canadians from investing or carrying on business abroad. In practice, however, the provisions of the present tax system leave much to be desired.

47. In paragraphs 6.8 - 6.11, the White Paper states that its proposals are not designed to provide an incentive to Canadians to invest abroad or to place barriers in the way of their doing so. We are not urging incentives which would encourage the export of Canadian investment capital that is so greatly needed at home, but we do believe that some movement of Canadian investment abroad is needed to open up foreign markets and to provide a basis for the most efficient utilization of Canadian resources. We point to specific failings of the present system, as well as the White Paper proposals, in the paragraphs which follow.

Specific Aspects

Credits for Foreign Taxes Paid

48. As a trading nation Canada depends heavily on its foreign currency earnings from exporting its goods, natural resources and

services. The ability to earn such income should not be weakened by measures which would place Canadians who invest internationally through Canadian corporations at an undue disadvantage compared with those who invest in corporations which earn their entire income domestically.

49. There are serious inconsistencies in the White Paper proposals as they affect Canadians in international business. For example, the tax consequences for a Canadian investing in a Canadian corporation would be the same if the corporation derived its entire income from (i) operations in Canada or (ii) a controlled foreign corporation engaged in bona fide operations in a non-treaty "tax haven" country that imposed no income or withholding tax. But if the Canadian corporation derived income from a controlled foreign corporation in a country which imposed tax (whether that country were a treaty or non-treaty country), the Canadian shareholder would receive less tax credit, and therefore less net income, than if the Canadian corporation's subsidiary were in a non-treaty "tax haven" country which imposed no income or withholding tax.

50. The White Paper proposes certain changes in existing foreign tax credit provisions, but the precise effect of these is not clear. The proposals relating to the flow-through of foreign withholding taxes,

however, seem complex and will create accounting problems for corporations, such as banks, which not only receive income from many countries but which also distribute dividends to shareholders abroad.

51. The White Paper proposes no departure from the present per country basis of computing foreign tax credits. This places the Canadian taxpayer at a distinct disadvantage compared with his U.S. counterpart who can arrange his foreign income for optimum tax credit effect. We consider that tax credit averaging provisions similar to those in the U.S. should be enacted in Canada. However, if the per country basis is to continue, the banks advocate that all foreign taxes suffered by a Canadian taxpayer on a particular source of income be eligible for credit. Often, a foreign branch of a Canadian bank will receive income which has already been subjected to tax in a third country. Under present provisions, the third country tax is not eligible for credit in the Canadian tax computation of the banks. We consider that the foreign tax credit should be the lesser of the Canadian tax or the aggregate foreign taxes suffered. We further advocate that allowance be given for taxes paid by corporations which themselves are the subsidiaries of a direct subsidiary corporation in non-treaty countries.

52. We are also strongly of the opinion that in the statutory definition of passive income a distinction should be drawn between financial institutions and "investors", as is the case under United States tax provisions. However, with respect to passive investment income in general, we understand that special taxation of this form of income by the United States taxing authorities has been difficult. We therefore feel bound to recommend against its adoption by Canada. Other ways of countering abuse should be explored.

Taxing Foreign Subsidiaries

53. It is a matter of concern that the planning of present and future Canadian international business may have to be done against a background of uncertainty regarding treaty negotiations. This is something of real consequence to all Canadians operating internationally, including the chartered banks, which at present are expanding on a world-wide basis in order to maintain their position in the rapidly increasing and extremely competitive international banking field.

54. In developing their international business, the banks have been alert to the growing desire in many countries for some form of local participation. Under the White Paper proposals, planning for

the establishment or expansion of local subsidiaries in the present non-treaty countries would become more difficult. Furthermore, in low tax jurisdictions the advantages could be denied to a Canadian bank, whereas a competitor from another country might well continue to profit from them. In fact the White Paper provisions would effectively negate any local tax incentives if a treaty were not eventually negotiated. In our view, the cumulative effect of the proposals, if passed unchanged, would be to place Canada in a non-competitive position compared with other countries.

Tax Treaties

55. The banks welcome government proposals to expand the network of treaties with other countries and to re-negotiate existing treaties. It is noted that Canada's future treaties will be influenced to a considerable extent by the draft model tax convention published by the Fiscal Committee of the Organization for Economic Cooperation and Development. We hope that the banks and other Canadian corporations operating in the international field will have an opportunity to make recommendations to the authorities on the form which Canada's treaties should take. For instance, we point out that Canada, like most other taxing countries, imposes its income tax on the net profits of business transactions. In the field of commercial lending, the net profits are computed by deducting from gross interest received (a) the

interest paid for loanable funds; and (b) other related costs. In international transactions, however, interest paid on commercial lending is often not distinguished from interest on investments, so that the source country imposes a withholding tax on the gross interest from commercial lending as well as on the gross interest from investments. Canada itself imposes a 15 per cent tax on loan interest flowing from a Canadian borrower to a foreign lender, even when the foreign lender is a financial institution unrelated to the borrower. The foregoing practice is reflected in Canada's present tax treaties with other countries where commercial interest is excluded from the definition of "industrial and commercial profits". We consider this an anomaly which should be corrected. New reciprocal treaties offer an obvious means of correction.

56. The banks commend the White Paper proposal that in future tax treaties Canada be prepared to recognize income taxes levied by political sub-divisions of foreign countries on a reciprocal basis. In Switzerland, for example, taxes levied by some political sub-divisions are higher than the federal tax burden.

Treaty Tribunal

57. In its brief to the Royal Commission on Taxation, this Association drew attention to the need for machinery for consultation

between countries on tax matters. We pointed out that the taxpayer's position is especially difficult if he must await assessment by both taxing authorities before he can be assured under present treaties that, in given circumstances, double taxation is to be avoided in accordance with the terms of the treaties. In its oral examination of the Association, the Commission asked many questions on this point and the banks gave examples of specific problems. It is worth recording that several banks have been waiting ten years for agreement on allocation of tax liability between the Canadian tax authorities and those of another country with which Canada has a tax agreement. The Royal Commission recommended that tax treaties should provide for a tribunal to resolve disputes and problems of double taxation. The banks urge early adoption of this recommendation and inclusion of such a provision in all future treaties.

APPENDIX "B"

SUBMISSION
on
PROPOSALS FOR TAX REFORM

by

THE BOARD OF TRADE OF METROPOLITAN TORONTO

Preface

The Board of Trade of Metropolitan Toronto has maintained a continuing interest in proposed or enacted government measures which may affect commercial affairs.

This interest is not unusual when one considers that Board membership now consists of more than 15,000 persons representing large and small business firms engaged in all phases of business activity. Although our membership is concentrated mainly in the Metropolitan Toronto area, the larger member firms conduct businesses which are provincial, national or international in scope. In light of the nature of its membership, the Board believes it can fairly claim to represent the views of a major cross-section of the business community of the Metropolitan Toronto region.

The Council of the Board recognized that the White Paper proposals were of singular importance to the business community and directed that the following steps be taken so as to ensure that the proposals received the fullest review. These were:

- (1) The establishment of a Steering Committee on the White Paper, the membership to be made up of certain of the Executive, Council and Taxation Committee.
- (2) Reference of the White Paper to the Board's Standing Taxation Committee for in-depth study and report to the Steering Committee.
- (3) Publication in the *Toronto Board of Trade Journal* of a detailed summary of the White Paper proposals with explanatory commentary. The Board's *Journal* is distributed to our members monthly.

- (4) Circulation of a letter to Board members suggesting that they write as individuals and as businessmen to government representatives expressing their views concerning the more significant proposals in the White Paper. Numerous copies of such letters were received by the Board.
- (5) The holding of two White Paper Seminars for discussion and exchange of views concerning the proposals between representatives of the Board's Taxation Committee and Board members. Response of our members to an invitation to attend these Seminars was such that a third Seminar was required. Approximately 1,200 members representing hundreds of other members in a wide range of capacities in Metro Toronto attended these Seminars.

Together these activities resulted in the preparation of the Board's brief. Its contents are the work of the Board's Executive, Council, Steering Committee and Taxation Committee.

The Board respectfully submits its brief to you for your consideration on the basis that the criticisms contained therein of the White Paper are as constructive as possible, and in the hope that we shall be given an opportunity to appear before you and speak to this submission.

James W. Kerr,
President;

J. W. Wakelin,
General Manager.

May, 1970.

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Summary

I Introduction:

- (a) Tax system should not adversely affect Canadian productivity — consideration should be given to taxes on consumption to maintain a balance of incidence of taxation.

II Tax Reform Procedure:

- (a) Not sufficient time given for review of White Paper in light of implementation date.
- (b) Reform proposals should be implemented in 3 stages, a year apart, the less contentious proposals first and so on.

III Economic Analysis:

Income tax proposals must be considered in terms beyond the revenue raising purposes since such proposals have substantial external effects on the economy. This is particularly true for the White Paper proposals which are so far reaching that their undoubtedly substantial effects can lead to a wide range of outcomes for the economy. In this sense, the White Paper proposals represent a risky experiment in policy making.

Though the authors of the White Paper have stressed equity as an important external effect in their proposed tax changes, they have limited the definition of equity to mean that all pre-tax income will be treated identically regardless of the sources of the income. If income recipients differ in how they use their incomes, the results of the White Paper proposals can be highly inequitable. It certainly is not equitable to treat the firm which needs income for re-investment the same way as the firm is treated whose income will be paid out as dividends.

The external impact of the proposals on economic growth has been ignored by the Finance Department. The higher degree of progressivity of the personal rate structure will tend to reduce household savings, increasing interest rates and inhibiting private sector growth. With higher middle income tax rates and capital gains tax, work incentive for managers will be reduced, encouraging earlier retirement and longer vacations, resulting in a reduction in the pool of man-

agerial and entrepreneurial talent so essential to the achievement of growth. The combination of dividend flow-through, capital gains taxation, and deemed realization of gains on the shares of widely-held companies will result in a shift of investment preferences away from riskier growth-potential companies to the shares of more stable, higher-dividend-yielding companies with lower growth potential.

The pre-dividend anti-capital gains bias will affect small, new, and reportedly growing firms which have the real value on internal financing. They must choose between reducing growth by increasing dividend payout or a reduction in the value of their equity. This anti-growth bias is magnified by the proposed distinction between closely-held and widely-held firms.

The differential treatment among shares of widely-held companies, shares of closely-held companies, and other assets will cause a shift in the relationship of before-tax yields on investments. Though the value of widely-held shares will be reduced as a result of the White Paper proposals, the values of closely-held shares, debt instruments, and real investments will be reduced even more.

The reduction in savings in the economy may not be fully offset by the re-patriation of foreign financial investments made by institutions since these institutions may be less attractive investment vehicles for savers under the White Paper proposals.

IV Individuals and Families:

- (a) Increased exemptions are approved. The \$500 additional exemption allowed at age 65 should not be conditional on non-receipt of Old Age Security pension. A further \$1000 exemption should be allowed at age 70.
- (b) Family unit (husband and wife) should have been proposed.
- (c) Child care and employment expenses are approved. Concern whether it is feasible for child-care expenses to be on a claim basis.
- (d) Fellowships, etc., should be taxed.
- (e) Unemployment insurance benefits should not be taxed.

- (f) Higher rates for middle income groups should be moderated.
- (g) Reduction of top rates should not be phased in but implemented immediately.
- (h) Reasons should be given why projected increased revenue is necessary.
- (i) Proposed 10% foreign asset rule has retroactive implications for existing pension funds and retirement savings plans. The present 10% foreign income rule should be maintained at least for existing funds and plans.
- (j) Income averaging provision should be less restrictive and provide for downswing of income as well as upswing.

V Capital Gains:

- (a) Adverse effect of a gains tax on economic growth at this stage of Canada's development.
- (b) Only one-half should be taxable as income subject to a maximum rate of 25% of the gain.
- (c) Five year revaluation of widely-held Canadian company shares should be dropped.
- (d) Deemed realization on change of Canadian residence should be abandoned or tax liability deferred until assets disposed of.
- (e) Valuation day — Alternative optional formulae as suggested by the Royal Commission should be permitted.
- (f) There should be a rollover in the case of the sale of shares of a closely-held company to a widely-held company in exchange for the shares of the widely-held company.
- (g) Provisions respecting partnership option and valuation of shares of the "partnership" should be clarified.
- (h) Stock options should be treated as in U.S. Existing stock options should not be taxed at a higher rate than under the present system.
- (i) Residential properties — Gains on sale should not be taxed generally. Exemptions are too low. Broader rollover provisions should be provided. Losses should be deductible.
- (j) Personal assets — Gains on sale should not be taxed.
- (k) Gains should be deemed to be realized at death, with tax deductible from estate, and estate tax rates should be reduced.

VI Corporations and their Shareholders:

- (a) Low rate on profits up to \$35,000 should not be entirely eliminated; instead, amount available for

low rate should be continued but be reduced by 50c for every \$1.00 of taxable income over \$35,000.

- (b) Distinction between closely-held and widely-held companies should be dropped.
- (c) Creditable tax should not have reference to tax paid by a corporation. Present 20% dividend tax credit should be raised to 25% or, alternatively, integration should be allowed at 50%, but, in either case, no refund of tax should be permitted.
- (d) If creditable tax with reference to tax actually paid is to be maintained, the 2½ year limit for distribution should be abandoned because it is unnecessary.
- (e) Inter-company distributions between Canadian companies should be tax-free.

VII Business and Property Income:

- (a) Goodwill should not be depreciable.
- (b) Existing provisions respecting entertainment and related expenses are sufficient to prevent abuse.
- (c) A loss caused by capital cost allowance on depreciable real property should continue to be allowed against other income, with restrictions applicable when the investor therein "trades up" such property.
- (d) Non-profit organizations should be permitted to deduct expenses incurred re income of investment portfolio.
- (e) Proposals respecting the taxation of accumulated incomes of family trusts are inequitable. The matter should be studied in depth.

VIII International Income:

- (a) Proposals will discourage foreign investment in Canada.
- (b) Non-resident withholding tax on interest payments to public institution payees should be repealed or reduced to same rate of foreign tax payable on interest.
- (c) Canadian combined rate of corporate and withholding tax on the income from foreign direct investment in Canada should be restricted to the greater of the Canadian corporate rate and the corporate rate in the recipient's country.
- (d) Increase of withholding rate should entail deductibility of carrying charges on funds borrowed to earn the income.
- (e) Tax changes should not inhibit Canadian foreign investment, especially in the less-developed countries.

Introduction

In shaping a tax system there are several factors which must be taken into account. Among the most important are the following:

- Economic viability
- Fairness and equity, both real and apparent
- Simplicity and certainty
- Administrative feasibility

To achieve fully all of these objectives and meld them into one system is a goal devoutly to be desired. The history of taxation indicates, however, that such a goal is susceptible only of approximate realization. What we can hope is that they be reconciled as far as possible and not disregarded unnecessarily.

It is our intent to review the main proposals of the White Paper in relation to basic principles and objectives and to point out some fundamental problems and criticisms of the proposals. We will also suggest revisions designed to overcome some of the main objections.

It is common ground that any tax system should bear as lightly as possible on the lower income groups. A basic objective of government is to improve the means and quality of living of all citizens and particularly those in greatest need. However, this should not be only a short run but a long run objective. It seems axiomatic that availability and distribution of consumer goods can increase only as production increases. Production depends upon capital investment and upon incentive for both management and labour. It is important not to kill, cripple or scare away the goose that lays the golden egg. A tax which has an adverse effect on production will eventually hurt the consumer at all economic levels.

Some taxes bear principally on consumption while others fall mainly on production. The latter may affect the ability or desire of producers to embark on projects, invest in them or work on them. While most taxes affect both consumption and production to some extent, it is usually not difficult to determine the general thrust of a particular tax or proposal.

A tax has psychological effects on "human" decisions which are often much greater than the consequences they might be expected to have according to a purely logical or mathematical basis. A punitive or unfair tax is discouraging and may have a greater disincentive effect than might be expected, while a tax exemption or benefit may create a strong stimulus for achievement which is out of proportion to the monetary benefit likely to be achieved by the taxpayer. As an object lesson one need only refer

to the stifling effects on investment, productivity and incentive that occurred in the United Kingdom after World War II as a result of excessive taxes imposed on incomes. Primarily, those taxes were to provide non-selective social benefits which the United Kingdom could then ill afford. Canada should avoid casting itself in the same role.

An important question to be considered these days is: What effect will the proposed tax system have on inflation? While the short-run effects are debatable, it seems clear that any system which depresses productivity while at the same time making more funds available to buy consumer goods will be inflationary over the long run.

The White Paper contains several desirable proposals for the improvement of the income tax law. The increase in exemptions, for example, is laudable and consistent with the change in the value of money. However, on analysis, some of the proposals appear to have an onerous and unfair effect. Their long term effects on incentive, investment and production may be much more serious than the government recognizes.

We cannot afford the risk which excessive taxation of income and capital gains would pose to the future growth of Canadian productivity. If greater revenues are necessary than reasonable levels of income taxation can provide to meet government expenses, the alternatives are to reduce government expenditures or to impose higher taxes on consumption. Consideration should have been given to the replacement of the manufacturer's sales tax by a tax on value added or by a retail sales tax of the kind recommended by the Royal Commission. These taxes are admittedly regressive and like all other taxes are unpleasant. However, they may be necessary to keep a balance between taxes which fall primarily on consumption and those which will affect our future productive capacity.

Consideration also should have been given to the combined effect of the White Paper proposals and the 1968 amendments to the Estate Tax Act. The estate tax (and provincial succession duties) should be modified and substantially reduced over a period of several years in view of the proposed taxation of capital gains.

The lack of proposals for administrative reform is disappointing. In particular, the proposals of the Royal Commission with respect to advance rulings and interpretations are most desirable. An indication by the government of an intention to co-operate with taxpayers in working out their problems would be very welcome and might introduce a new and constructive era in relations between the Department of National Revenue and taxpayers.

Tax reform procedure

The government is to be commended for placing before the public at large its proposals to achieve tax reform. Public discussion of matters, which may be translated into legislative action and which are of vital importance, is an essential part of the democratic process. To the extent that this has been accomplished we congratulate the government. We seriously doubt, however, that sufficient opportunity has been given to conduct a full-scale study of the proposals commensurate with their far-reaching effects.

Many of those who have specific objections or are concerned about one or more aspects of the White Paper proposals have found it virtually impossible to express their concern in a constructive way in view of the difficulty of presenting workable alternatives to individual proposals that would mesh with other proposals that may or may not be adopted. Thus a good deal of the genuine concern has found itself effectively driven into participation in a broad attack on the whole White Paper package. This can only be expected to provoke a purely defensive response from the government, and all critics of the White Paper will be labelled as opponents of tax reform — as if the White Paper proposals were the only possible alternative to the present system.

This unfortunate situation was probably inevitable in view of the scope of the White Paper proposals and the impossible timetable established for review and implementation. The White Paper just covers too much ground to be dealt with in such a short time.

Even if the entire population agreed with every proposal in the White Paper, we question whether it could have been put into satisfactory form and enacted (even sight unseen) by Parliament by January 1, 1971.

Far too little time was given for —

- (a) the major job of planning the administration of a radically different tax system;
- (b) training tax department staff, developing new forms, new reporting and record-keeping procedures; and
- (c) informing the public about their new obligations.

But, quite apart from this, it is painfully evident that there is nothing approaching unanimous approval of the White Paper proposals.

What seems clear at this stage is that the White Paper attempts to accomplish too much in one dramatic surge of effort. It is virtually impossible to distinguish the essential changes from those that are unnecessary and overly complex or burdensome. The relationship of one proposal to another is difficult to discern, and this complicates the problem of developing sensible solutions to problems that must be dealt with. It seems to us that there is really only one satisfactory way out of our present predicament; viz: the government must develop a revised program of tax reform that can be considered and implemented *in stages*:

- (a) Stage 1 would deal with the changes most urgently required that could be implemented without difficulty on January 1, 1971.
- (b) Stage 2 would cover other changes that seem to be clearly warranted but that for administrative and other reasons will require more time to develop properly and implement without undue disruption.

The target date for these changes might be January 1, 1972.

- (c) Stage 3 would deal with other more controversial proposals that require considerably more time for review and discussion.

If this were done, the debate could proceed in a reasonably orderly way. The proposals for each stage could be considered rationally on their merits in the context of the overall program of tax reform.

Stage 1

We believe that it would, at this stage, be difficult if not impossible to develop a satisfactory form of capital gains tax, and have it ready for implementation by the end of this year. This does not mean that none of the important reform proposals could be effected on January 1, 1971.

Some progress could be made on revision of exemptions and the rate structure to relieve the burden on low income groups.

Steps could be taken to restrict the opportunities for avoidance of tax in areas where there are significant loopholes, and a number of other proposals can be put into effect without further delay.

These changes should be scheduled for Stage 1 of the reform program and not left until the rest of the program has been prepared for implementation.

Stage 2

The next stage would probably include the development of a satisfactory form of capital gains tax, preferably accompanied by reduction of death duties with the co-operation of the provinces. This should provide the basis for further revision of the personal rate structure.

If attention can be concentrated fairly directly on the problems involved in establishing a reasonable system for taxing capital gains, it should be possible to complete Stage 2 by the end of next year.

Stage 3

We suggest that the extremely complex and controversial proposals for integration of personal and corporation tax, and the treatment of international income be left until Stage 3.

We think these proposals should be considered much more carefully than is possible while other more urgently required reforms are being debated.

In view of their complexity, and the difficulty of the problems that they present, it would be foolish to rush them into law without a serious assessment of their merits, considered separately from other tax reforms that are more clearly warranted and that can be implemented without serious difficulty.

CONCLUSION

We feel most strongly that a practical program of tax reform in digestible stages is urgently required.

We do not for a moment underrate the political difficulties for the government in undertaking a major revision

of this kind to its tax reform proposals. The development of a satisfactory form of capital gains tax that could be introduced and put into effect without any fundamental change in the present system of taxing corporations and shareholders would not be a simple matter. It is not a job that a government under intense pressure is likely to be enthusiastic about.

On the other hand, if something along these lines is not put forward pretty soon, it will become increasingly difficult to avoid being forced to choose between accepting the White Paper pretty much as is, with only relatively minor changes (with the knowledge that a lot of it has not been adequately assessed), or rejecting the whole thing and starting all over again.

Economic analysis of the White Paper

EXTERNALITIES AND TAXATION

Externalities is an economic term, referring to costs or benefits that are not counted as part of the costs and benefits of a proposal. For example, the social costs of pollution resulting from building a factory are not included in the projected profit and loss statements that the firm examines in making its decision. Yet, the pollution cost will have to be borne by someone. A similar example can be used for external benefits. A factory proposal would not include the reduction in welfare payments and other social benefits that result from bringing new job opportunities into an area with substantial unemployment. Yet, the benefits are very real.

Tax proposals have externalities also. For instance, the purpose of a sales tax may be to increase governmental revenues. However, there may well be a reduction in consumption of the taxed product which is reflected in reduced production and employment. These costs are externalities with respect to the sales tax. Almost all tax systems have externalities in the sense of shifting or redirecting economic activity. The external costs and benefits of a tax system need not be purely economic. Income equalization, for example, is a possible goal of a tax programme which would have external effects combining economic, sociological, and political factors.

Income tax proposals are very apt to have substantial externalities, not all of which may be clearly recognized by the proposers of the programmes. By defining taxable income in certain ways, by permitting some expenditures to be deductible and others not deductible, by applying different rates to various kinds of income, and even by the timing of when taxes become due, income tax systems can have substantial external effects. These include shifts in consumption-savings decisions, choice of investment media, and the basic choice between work and leisure. The economy adjusts to the externalities imposed on it by the tax system. When the system is changed, the economy readjusts. We intend to analyse the kinds of readjustments that may occur as a result of the White Paper proposals and, where feasible, to make recommendations for modifications to reduce the impact of undesirable externalities.

THE IMPACT OF THE WHITE PAPER PROPOSALS — THE MASSIVENESS OF SHIFTS IN EXTERNALITIES

The scope of the White Paper proposals is enormous and complicated. Literally, it will affect the entire economy. New classifications of business are proposed. Taxable income is redefined and broadened immensely. Allow-

able expenses are redefined. Tax rates are changed. Not only will international capital flows be affected indirectly by what happens within the domestic economy, but changes are made directly to the taxation of international capital flows.

If externalities did not exist, one could simply recalculate the tax bill and measure the impact of the proposals. This essentially is what the government has done (particularly for corporations) in its calculations showing the effect of the White Paper proposals.

However, externalities do exist. Unfortunately, a complete measurement of the impact of these externalities — both positive and negative — involves a technology which is beyond the state of the art in economics at this time. This means that there has to be considerable uncertainty with respect to the total impact of all of the externalities. Neither we nor the government know what the effect of the White Paper will be. The range of possible outcomes is very large so that the proposals constitute a very risky package. Given this situation, the complex set of proposals presented by the Minister of Finance might have been properly treated in a quite different way. Instead of presenting a complex package, the impact of which is difficult to evaluate, a simpler, less comprehensive proposal could have been presented initially. After the effects of the more modest proposal had been digested, subsequent steps could be evaluated on their merits. In effect, we argue that it is a good maxim to move slowly and carefully if you are not sure of the road.

SPECIFIC EXTERNALITIES

Equity

The externality called equity is given heavy emphasis throughout the White Paper. The interpretation of this comes from the Carter proposals in which it is defined as the principle whereby "a buck is a buck". In general, the aim is to leave people who have the same before-tax income with the same after-tax income, or at least more nearly the same than under present tax legislation.

This is a very limited definition of equity. In a full sense, those individuals with the same before-tax incomes should be left the same with respect to *consumption*, not merely after-tax income. In order to accomplish this, it would be necessary to allow deductibility of *all* excise taxes, since consumption patterns are not the same. For example, the man who buys a high proportion of manufactured goods tends to pay higher excises (including tariffs) than does someone who spends a large portion of his income on agricultural products. The latter not only avoids a number of excises, but also benefits from the

various subsidies made available to farmers. It is not clear that the White Paper proposals would increase equity at all, when equity is given a broader definition.

When applied to business firms, the notion of equity as defined in the White Paper is not only inadequate, but could result in a considerable reduction in equity. A buck is not a buck if one of two firms earning the same before-tax income has to rely on internal funding, while the other has relatively easy access to financial markets. In the former case, the dollar taxed is a reduction in the firm's growth potential, which is quite different than taxing to reduce dividend pay-outs. By applying a flat rate on all corporate income, regardless of size of firm and its access to sources of external financing, the White Paper treats firms which rely on internal funding with less equity than does the current law. Existing legislation allows small firms — which typically have to rely heavily on internal funding — a lower marginal tax rate than large firms.

Equity is more a sociological concept than an economic one. Hence it is not easy to value this externality in an absolute sense, even if equity is defined in the broad sense. Hence, we must try to value equity in a relative sense. To achieve the externality called equity, what external advantages of the existing tax system are foregone?

Growth

Most of the cost of equity is paid for in growth potential of the private sector. Though several specific anti-growth aspects will be treated separately below, the overall impact is so strong that it merits separate comment. With one possible exception (the impact of the White Paper on foreign investments made by financial institutions), every other proposal will reduce growth. In most instances, required rates of return on both real and financial investment will be increased because the supply of savings will be reduced. This applies both to personal and business savings. If the anti-growth effect occurred as a result of only some of the White Paper proposals, the new tax scheme would not be too frightening. This, unfortunately, is not the case. The aggregate impact of the proposals all moves in one direction — namely to reduce the growth potential of the private sector of our economy.

Even more frightening is that, not only do virtually all of the proposals have anti-growth elements, but they are apt to interact so that the total effect on Canadian growth will be greater than simply the sum of the individual impacts. For example, if, as we argue below, the redistribution of income results in a reduction in savings, firms will face higher interest rates than they would under our current tax system. With higher interest rates, some investment projects will not be undertaken that would have been undertaken with the interest rates under the current tax system. Firms and workers that would have been used to build the plant or manufacture the machinery that will not now be built or manufactured will receive smaller incomes. This reduces their savings and their spending. The further reduction in savings will tend to push interest rates even higher. The reduction in spending will reduce business receipts, making expansion of plant and equipment even less attractive. Thus, the effects tend to snow-ball as they work their way through the economy.

The snow-ball, anti-growth impact can be traced from any of the specific anti-growth externalities described below. Given the snow-balling effect, and the fact that

there are virtually no offsetting positive growth effects, the individual cases discussed have to be viewed very seriously. Even though the individual effect may not be large in itself, its interaction with all of the other anti-growth proposals could have extremely serious consequences for the future of our country.

Persons. The over-all effect of the rate structure changes, including the taxation of capital gains, is to shift the distribution of income from the upper and middle income groups to the lower income groups. Since all studies show that savings as a proportion of income tend to decline as income falls, it is reasonable to conclude that total savings will be reduced by the rate structure change. The White Paper agrees with this conclusion. With lower total savings, interest rates should rise, all else equal. This, in turn, means that marginal real investment projects, which are feasible under current tax laws, will be unprofitable with higher interest rates. In aggregate, the total of real investment should fall, reducing economic growth. It is not evident that the authors of the White Paper took the interest rate effect into account.

With capital gains taxation and higher middle bracket rates, there may be a shift in the work-leisure choice, in favour of leisure. This can be dismissed too easily on the basis that people have to earn in order to live, regardless of taxation. Admittedly, the number of people who may make the choice in favour of leisure under the White Paper proposals may be small, but they are likely to be an important group. The man who has done well can afford an early retirement. Under our present tax laws, he may well decide to continue working, whereas he may well decide to retire under the White Paper proposals. This kind of man is apt to be entrepreneurial and highly experienced at successful management. Without him, the reduction in growth is more than the marginal product of a single worker, but must include the job and capital creation which his entrepreneurial activities would have helped to create. Many studies have demonstrated a shortage of managerial competence in the Canadian economy and have argued that our growth suffers from this shortage. Though it is difficult to estimate the number of such entrepreneurs that would be lost as a result of the White Paper proposals, even a small number would be sorely missed and would have an adverse effect on our growth.

The White Paper assumes that the gross-up of personal and corporate taxation via dividends and taxation of capital gains will have little impact on personal savings. This is a contentious area and precise estimates are not possible. Clearly, however, the combined dividend gross-up and capital gains taxation tends to make dividends relatively more desirable than capital gains, as compared to the case under our present tax laws. At the margin, and it may be a large margin, there will be investors who will prefer dividends to capital gains as a result of the White Paper proposals. Some of the dividends may be reinvested in the market, but some may also be consumed. To the extent that increased dividends are consumed, savings are reduced and interest rates (including equity yields) are forced up. This, again, will have the effect of reducing real investment and growth.

The change described above is quantitative. The qualitative change in individual investment behaviour may be even more significant. Investors who would have been

willing to provide high risk, venture capital with untaxed capital gains may find the risky investments less attractive with taxation of capital gains. It makes little difference that capital losses can offset capital gains, since few venture fund suppliers would enter a situation where they really expected to incur losses. These investors may now prefer lower yields, but safer investments. This would increase the required yield on venture capital, making it more difficult for new, high growth potential firms to get started. In Canada, where development is needed so badly, this qualitative shift away from risky ventures could be more destructive of growth than the probable decline in total savings.

Finally, the 5 year deemed realization on widely-held shares will have a number of adverse effects on the economy and its growth through its effects on individuals. At the margin, many investors, discouraged by the prospects of losing the additional earnings made by reinvesting a postponed tax, may move away from stocks that have the potential of generating capital gains. To the extent that these investors shift into consumption, savings again are reduced. To the extent that these investors shift to mature companies, that promise dividends rather than capital gains, there will be a qualitative shift against growth firms requiring venture capital.

Unfortunately, the anti-growth effects of the 5 year deemed realization do not stop at this point. There are well-to-do families in Canada with family portfolios containing large amounts of widely-held stocks. In many cases, the stock portfolio is part of a family business so that the pressure of a 5 year deemed realization might force such a type of business to go public in order to pay the tax. Such families will be under pressure to redomicile out of Canada as a result of the 5 year deemed realization. If is reasonable to expect that the future investments of these redomiciled fortunes will tend not to be made in Canada. Again, the supply of funds is reduced, reducing growth.

Businesses. The anti-growth tendencies of the White Paper affecting individuals simply mirror the problems confronting firms. Firms which have traditionally, and perhaps necessarily, relied upon internally generated funds to finance growth will be under market pressure to issue dividends, since capital gains will be taxed and dividends offer stockholders a tax benefit. If the firms continue to retain earnings, as they had prior to the enactment of the White Paper proposals, they will find their share values dropping relative to share values of companies with high pay-out ratios. The effect of this will be to raise the cut-off rate required of internally financed investments and, as a result, reduce the volume of such investments. If firms attempt to use external debt to finance these projects, the demand for debt funds will increase, raising interest rates and forestalling growth. If firms issue additional external equity, equity yields will rise, increasing the cut-off rate on investments financed by external equity, and again reducing growth. If we assume that firms using internally generated funds do so because these are the cheapest funds available, it is clear that a reduction in the availability of these funds has to reduce real investment.

The argument that firms can satisfy the desire of stockholders for the tax flow-through benefits of dividends by issuing stock dividends is not in general correct. To be sure, the stockholder's desire for the tax concession is

met. This may be of little value for those many investors who are in the 50% personal tax bracket. Having received the stock dividend, the incentive to keep it is less than under existing tax legislation because of the taxation of capital gains. There is a fairly high probability that stock dividends will be sold. The effect of these sales would be much the same on share values as if firms had instead issued stock directly to the market. In general, cut-off rates will be raised and marginal investments abandoned, once again reducing growth.

The qualitative shift again holds. Firms which are mature with little growth potential tend to pay out most of their earnings. On the other hand, new and small firms must rely on internal funds. Under the White Paper proposals, these firms will have difficulty raising funds. In general, investors will prefer the shares of mature firms. Since the new firms are often those with great growth potential, the growth rate of the economy would be reduced.

The differential treatment between widely-held and closely-held firms operates perversely. Though not all closely-held firms are new, growth companies, many are. Yet, the proposals with respect to closely-held firms result in a higher ratio of after-tax value of dividends to capital gains than for widely-held firms. Closely-held firms have a 100% dividend flow-through, as compared to the 50% flow-through for widely-held firms. Thus, for a given investor, the after-tax value of a dividend from a closely-held company is greater than from a widely-held company. The capital gain of the closely-held company is fully taxed whereas the widely-held company's capital gain is taxed on only 50% of the capital gain. This makes the after-tax value of a widely-held company's capital gain larger than that of a closely-held company. The perversity of these provisions lies in the fact that the pressure for dividend payout will be greater on closely-held firms. If anything, the system ought to encourage mature widely-held companies to pay out dividends, and facilitate the retention of earnings by closely-held companies.

FINANCIAL INSTITUTIONS AND CAPITAL MARKETS

The shares of widely-held companies will probably increase in value relative to other financial assets, although they will tend to be lower than they would under present laws. Supply of widely-held shares will probably increase because of the capitalization of earnings through stock dividends, and the subsequent sale of these dividends. Also, shares which have been held for purposes of capital gains will tend to be sold. Finally, the 5 year deemed realization provision likely will force some sell-off in order that taxpayers generate the funds needed to pay the taxes.

The demand for widely-held shares should probably increase also. Pension funds will be forced to increase their holdings of Canadian investments or face taxation. Mutual funds will be pushed into Canadian equity markets since flow-through provisions and the 50% of capital gains tax holds only for widely-held Canadian equities.

In the long run, the institutional shift into the Canadian equities markets may be less than is anticipated. If growth is reduced as a result of the White Paper, some institutions may be willing to forego tax relief or dividend flow-throughs in order to attain more favourable growth outside of Canada.

If we assume, as appears reasonable, that financial institutions have purchased foreign securities in order to achieve a portfolio superior to that which could be achieved with Canadian securities only, it follows that the repatriation of these funds will result in a less desirable portfolio. The poorer performance of the post-White Paper portfolio could result in some switch from purchase of claims on financial institutions to consumption. Even if people simply switch to direct investments, these institutions are likely to suffer as a result of the tax proposals.

Debt instruments as well as all other assets will suffer relative to the shares of widely-held companies. All of these assets will be subject to full taxation of capital gains and, except for the shares of closely-held companies, offer no equivalent to the dividend flow-through tax credit. In order to maintain the same after-tax yield differentials among these claims that prevailed prior to the adoption of the White Paper proposals, the before-tax yield differentials will have to narrow. This implies an increase in the before-tax yield on debt, i.e., an increase in interest rates.

CONCLUSION AND RECOMMENDATIONS

In their drive toward achieving equity, the authors of the White Paper have made proposals which seriously threaten the growth of the economy by reducing savings,

raising required yields on real investments, and biasing the system against the financing of new growth companies. Though there have been some, we think, inadequate attempts to measure the impact of the anti-growth effects on households, no attempt has been made to assess the effects on businesses. Instead, it has been assumed that firms will behave the same way under the new tax system as they do under the existing system. This results in a serious under-estimate of the total anti-growth impact.

We have been assured by the authors of the White Paper that if growth reduction occurs in the private sector, it can be made up by government spending. This certainly is a possibility. Many may object to this solution, which implies a much larger role for government than has been the case in the past. Aside from political objections, the solution proposed to cure the anti-growth impact has not been evaluated. *There is no evidence that suggests it is cheaper to have government finance a given growth rate than it would be to have a tax system which offers incentives so that the private sector will finance growth.* This is but another example of a general lack of willingness to consider the costs of the White Paper proposals. Basically, we do not believe that the Department of Finance has made the case that it has provided a set of proposals which will be equitable and yet not unduly affect the growth of our economy.

Individuals and families

PERSONAL EXEMPTIONS

The proposed increase in personal tax exemptions so as to free some 750,000 persons from paying tax is regarded as proper recognition of inflationary trends. As noted in the White Paper, this is the first revision in the past twenty years. Such exemptions should be reviewed on a regular basis to reflect cost-of-living changes and revised upwards (or downwards) at intervals of not less than five years.

While the increase in personal tax exemptions coupled with the new rate schedules will give some assistance to persons in the lower income levels, it is considered that additional assistance should be offered to older retired persons. A high proportion are dependent on fixed incomes and have no opportunity to increase their income to meet higher taxation and living costs. To recognize this problem, the additional personal tax exemptions of \$500 presently allowed at age 70 should be allowed at age 65, without regard to whether the taxpayer is in receipt of the Old Age Security Pension. Further, we recommend that an additional \$1,000 be added to the personal tax exemptions otherwise allowed in respect of taxpayers who have attained the age of 70 years. The cost of implementing these recommendations would be minimal in comparison with the benefits that would be derived by elderly taxpayers.

FAMILY UNIT

Gift tax and estate tax provisions both recognize husband and wife in a family unit context. To give further

effect to this concept, we would favour the introduction of an option to file a joint return for husband and wife with each paying tax based on one-half the aggregate income. This would have the effect of doing away with the anomaly whereby under Section 21 of the Income Tax Act the transferor is still liable for tax on the income derived by his spouse from the gift and, presumably, will also be liable for tax quinquennially on deemed gains if the gift consists of shares of widely-held Canadian companies even though transfers of property between spouses are now free from Gift Tax and Estate Tax.

CHILD CARE EXPENSES

The allowance of child care expenses as a tax deduction is sound in principle. It is foreseen, however, that this type of deduction is one which is wide open to abuse. Effective administration is bound to be costly and we have grave doubts concerning whether such administration would not inevitably entail undue government investigation of family affairs.

EMPLOYMENT EXPENSES

We support the proposed deductibility of employment expenses by way of a maximum annual allowance of \$150 without the necessity of keeping records of expenses. Arbitrary though the allowance may be, the arguments against allowances of such expenses on a claims basis, as set forth in the White Paper, are valid. Comment will be made on the so-called "expense-account living" when dealing with Business and Property Income.

ADDITIONAL ELEMENTS OF INCOME TO BE SUBJECT TO TAX

The Board supports in principle the proposals to tax grants for fellowships, scholarships, bursaries and research. Further we support the proposal to revise the tax treaties in order to abolish the two year exemption on teaching salaries in the case of teachers who have come from abroad on a temporary basis. This seems fair, since it would place all teachers on the same footing.

The proposal to tax the members of the armed forces on the same basis as other Canadians is equitable also.

We doubt, however, the wisdom of taxing unemployment insurance benefits (with employees' contributions being deductible). The reason given for the proposed change is that there are some employees employed for part of a year whose receipt of tax-free unemployment insurance payments plus their earned income may, after tax, be greater than the after-tax income of other employees who have worked the full year for the same amount of gross income. Admittedly, this is an inequity, but its cure should be found within the Unemployment Insurance Act — not the Income Tax Act. By and large, those claiming unemployment insurance need every last dime to which they are entitled. It is wrong, we think, to tax these beneficiaries simply because of a special situation.

CHANGES IN RATE SCHEDULE

We are not at all convinced that the inclusion of capital gains in income in full or in part will affect only the well-to-do or the wealthy. We believe that the broadening of the tax base in this way will sweep into income the gains of many thousands of taxpayers who do not enjoy the appellation of wealthy or well-to-do, i.e., the middle income group. This group we consider to be those whose annual gross income is within the \$12,000 to \$25,000 range.

Those with middle incomes, according to the White Paper, are to be subjected to even higher rates than now exist and the rates are to be applied against a broader tax base. The members of this group — tomorrow's leaders of the Canadian economy — are undoubtedly being called upon by the White Paper to take on an even heavier tax burden than that which they already bear. Is it to be expected that they will do so — albeit grudgingly? We are fearful that the answer may well be in the negative.

Many, and compelling, are the intangible reasons for staying where one's roots are, but the history of our own country, and of other countries, reveals that these reasons may count for nought if economic opportunity pulls in another direction. Moreover, in our view, Canada as a still-developing country must still be a substantial net importer of people possessed of managerial and technical ability. Canada cannot afford to be a net exporter of such skills. Are the higher rates and the broader tax base going to put us in that position? We think so. This is one of the reasons why we have advocated that if capital gains are to be taxed, only one-half of such gains be included in income. And it is also the reason why we advocate that the proposed yet higher rates be considerably moderated, at least to the point where the Canadian rates compare favourably with U.S. rates (taking into account, of course, the liberal and recent deductions permitted in the United States).

The present high rates of tax on personal incomes should be reduced at the outset, as recommended by the Royal Commission on Taxation, to the rates ultimately intended by the White Paper.

The retention of high rates of personal tax over the first five years will tend to defer distributions and realizations of gains and is unfair in view of the immediate taxation of gains. Substantial capital gains may be realized in the early years notwithstanding the valuation date proposals. The long period of transition causes concern as to the eventual reduction of the top tax rate to about 50%. An immediate change of the top rate to about 50% would have a very beneficial effect on incentives and on the confidence of higher income taxpayers in the fairness of the proposals, nor would it involve a major reduction in projected revenues.

INCREASED REVENUES

At this juncture we should like to note the statement in paragraph 1.3 of the White Paper:

"The needs of the federal and provincial governments for money to do useful and important things are so great that we cannot now afford to reduce the overall revenues from personal and corporate income tax."

However, we find from Tables 15 and 16 of the White Paper, which are based on 1969 incomes without any allowance for an increased G.N.P., that net federal revenues will increase by \$630 million five years after implementation of the proposals. (Responsible analysts have projected much higher estimates.)

Few would quarrel with the above-quoted statement, but we do take issue with government proposals which will divert substantially more tax dollars to federal coffers than at present without any reason for requiring such increased revenue being given by the government.

Imposition of taxation, everyone agrees, can only take place with the consent of the governed, i.e., the taxpayers. Such consent, if it is to mean anything, must be informed consent. It is wrong in principle, we submit, to ask taxpayers to consent blindly to increased taxation on the basis of a moral undertaking that rates will be reduced if more revenue than required is being raised.

Historically, our form of government has traditionally required that an explanation be given why additional revenues are needed when legislation is introduced to increase or levy new taxes. We believe that the proposals of the government in the White Paper should be adjusted so that this tradition is maintained.

PENSION PLAN AND RETIREMENT SAVINGS PLANS

INVESTMENT PORTFOLIOS

The proposed requirement that the foreign assets of these plans must not exceed 10% in order to retain their tax-free status amounts to retroactive legislation respecting those investment portfolios which have complied with the present 10% foreign income rule, but will not be in compliance with a new 10% foreign asset rule. The managers of such plans can speak with better authority than we concerning the many effects there will be in switching their investments to comply with the new rule. Certainly, however, forced purchases in a particular market will tend to create artificially higher prices.

In our view, the new rule should be applicable, if at all, only to plans which have come into existence after Nov. 7/69 and to those plans whose investments portfolios consisted of less than 10% foreign assets as of that date. In any event, when new rules are promulgated for the investment of such funds, a sufficient time period should be allowed to dispose of foreign assets in excess of the 10% limit.

WITHDRAWAL OF SAVINGS FROM PENSION PLANS AND RETIREMENT SAVINGS PLANS

It is proposed that a widow would be permitted to offset or reduce her taxable income if she contributed all or part of lump sum withdrawals to a registered retirement savings plan of her own. This proposal should apply to the surviving spouse and not be restricted to a widow.

RESPONSIBILITY OF TRUSTEE

Where new rules require the trustees of a pension or retirement plan fund to be liable and responsible for paying taxes, it should be made clear that such responsibility involves no more than the withholding of a flat percentage tax.

DEDUCTIBLE CONTRIBUTIONS

We commend the intentions expressed in the White Paper to work towards a more equitable formula for

pension fund contributions which would relate to benefits provided.

INCOME AVERAGING

Few will quarrel with the concept of income averaging; many will argue over method.

Theoretically, one's income for tax purposes should be averaged over the total number of one's income-producing years. There seems little likelihood, however, that such averaging will become practicable, at least within the foreseeable future. This bleak prospect should not prevent an attempt at approximating ideal averaging, and we commend the White Paper for its proposals that an averaging formula be generally available to all taxpayers. However, the mechanics of the formula, we believe, are too restrictive and should be broadened so as to provide truly effective relief to taxpayers with accelerating incomes. Incomes on the downswing should also be considered in establishing averaging provisions.

The adequacy of the limited averaging provisions may be questionable in respect of substantial capital gains or losses. Taxation of gains at rates substantially higher than the marginal rates applicable to the period during which such assets are owned, and relief for losses at rates substantially below the marginal rates applicable to the period of ownership may be seriously inequitable, particularly for taxpayers with relatively small incomes.

Capital gains

We have previously expressed our opposition to a capital gains tax and still feel strongly that such a tax will have an adverse effect on Canada's economic growth which, we submit, has been based to a considerable extent on the absence of a capital gains tax. Our commentary on the various proposals for a capital gains tax and our suggested changes for alleviating the adverse effects of these proposals are not to be taken as agreement that a capital gains tax is desirable at this stage of Canada's development.

RATES OF CAPITAL GAINS TAX

The taxation of all capital gains (save for certain exemptions or deductions and on the shares of widely-held Canadian companies) at full rates seems unreasonable — in light of the taxation of such gains in the United States and the United Kingdom. In those countries, whose economies are a good deal more mature than our own, only one-half of long-term gains are included in income, subject to a maximum overall rate. In the United States there are reasonably broad rollover provisions in the case of realizations of gains by the American taxpayer. And when he dies his assets are received by his beneficiaries at their then current value for capital gains tax purposes in the event of subsequent sale or gift. There seems little doubt that the American tax on capital gains (and proposed increases) are less onerous than the capital gains tax proposals in the White Paper.

Capital gains inherently contain a large element of inflation. A gain in dollar terms may actually be a loss in

real value. Moreover, the taxation of inflated gains at full rates is really taxation at a higher effective rate than that of ordinary income. We believe that there will be serious economic consequences for Canada if capital gains made in Canada are taxed more heavily than gains made in other countries, especially those countries which are prime capital sources.

We submit that only one-half of all capital gains or losses should be included in the calculation of income, without distinction between gains on shares of widely-held corporations and gains on other assets. The maximum tax should be no more than 25% of the gain. (The tax imposed on one-half of all gains on shares should be an answer to most problems of surplus stripping, since it would be roughly equivalent to the tax on corporate distributions).

All other things being equal, such a change would cause an appreciable loss of potential revenue. This loss, however, in our view would be made up if our suggestion (made further on in this brief) is adopted that the integration proposals be replaced by a dividend tax credit of 25% or, alternatively, integration be allowed at 50%. In either case, such would be applicable respecting all Canadian corporations and be non-refundable.

QUINQUENNIAL EVALUATION

The proposal to revalue shares of widely-held Canadian corporations is unfair. A major block of shares of a widely-held corporation may not be readily marketable and is more akin to a holding in a closely-held company

than to that of a portfolio investment. The proposal would probably force sales of large blocks of shares, force down the market price of such shares and disrupt continuity of ownership and management unnecessarily in many cases. The following additional objections may be made to the five year revaluation proposal:

- (a) The owner may be taxed on an unrealized gain and the shares may later become worthless, but no tax relief would be available if he has no other income from which to deduct the loss. The market is subject to many fluctuations and there is no assurance that the taxpayer could sell his shares at the price quoted on his quinquennial valuation date.
- (b) The proposal could inhibit closely-held companies from going public.
- (c) Revaluation may cause pressures on the market at each month-end and wash sales may affect the market at year end.
- (d) Speculators and others might be expected to take advantage of the tax position of a major shareholder on his quinquennial valuation date.
- (e) The pressure on a large shareholder to find funds to pay the tax may require a distribution from the company which is not in its best interest.
- (f) The proposal may result in sales of major blocks of shares to non-residents if they are not subject to the same rules and the same rates as Canadians.
- (g) Revaluation for some taxpayers may be delayed almost 10 years, whereas others will have to pay tax at the end of 5 years from the valuation date. This is not equitable.
- (h) Over an extended period of time it seems logical to conclude that the net tax payable as a result of the revaluations could be in excess of 50% of the capital gain due to the loss of income from and appreciation in the shares that are sold to pay the tax. This is likely to result in a tax far in excess of that which is apparent.
- (i) Foreign parent companies are penalized who have complied with Canadian government policy by making available to Canadians shares in their Canadian subsidiaries.

We submit that the proposal for deemed realization of the shares of widely-held Canadian companies every 5 years should be dropped.

CHANGE OF CANADIAN RESIDENCE

The proposal for a deemed realization on ceasing to be resident in Canada would erect a White Paper wall around Canada and would unduly restrict mobility. This is particularly undesirable when applied to persons who are transferred abroad by their companies or who wish to go abroad for training or experience. The proposal would also make Canada much less attractive to non-residents coming to Canada for an extended period of time for a particular project or purpose. It appears they would have to evaluate their world-wide assets and pay a capital gains tax on leaving Canada respecting any increase in value of those assets which has accrued as of departure.

The proposal respecting deemed realization of capital gains on leaving Canada seems to be an implicit admission that the proposed capital gains tax is onerous

enough to drive people out of the country. If this proposal is not abandoned, at the very least provision should be made for deferment of tax liability until assets are in fact disposed of, perhaps subject to the posting of adequate security. Such deferment would be vital in the case of property which has appreciated in value but for which there is no ready market, e.g., rental real estate. In addition, a loss should be allowed to be carried back for more than one year since a longer period may be required to provide full recovery.

VALUATION DAY

The valuation of assets at the valuation date cannot possibly be made on a sound basis. There are not enough appraisers available. Since valuation is such an inexact science at the best of times the sheer volume of work would result in many unsound and fanciful values being used. The counter-pressures of capital gains tax and estate tax will have some beneficial effect, but in many cases these counter-pressures will not be equal and in many others estate tax will not be a factor. Also, it seems unfair to tax gains calculated by reference to the value on valuation day where the cost of the asset to the taxpayer was higher than the value on valuation day.

There should be alternative optional formulae for valuation of assets at the valuation date. A method of proration of the profit according to the time the asset has been held, along the lines recommended by the Royal Commission, would seem feasible and highly desirable.

CONVERTIBLE DEBENTURES

Gains and losses realized on the sale of convertible debentures of widely-held Canadian companies trading at prices in excess of par value should be treated in the same manner as gains and losses on shares of such companies.

ROLLOVERS

Gains realized on the sale of a widely-held company are to be taxed only to the extent of 50%, even though the increase in value arose while the company was a closely-held company. This treatment and the reasons for it are explained in paragraph 4.45 of the White Paper. While the same reasoning would seem to apply to the sale of shares of a closely-held company to a widely-held company in exchange for shares of the widely-held company, or to a merger of a closely-held company with a widely-held company, it is apparently contemplated that such transactions would be regarded as taxable realizations, and that the gain realized by the shareholders of the closely-held company would be taxable in full (3.47 and 3.51). We submit that this treatment would result in onerous taxation of gains resulting from the development of earnings potential in a closely-held company, unless the company was converted to widely-held status prior to disposal or merger. It would be particularly damaging in the case of incentive arrangements under which key employees of a closely-held company, controlled by a widely-held company, have a minority shareholding interest subject to repurchase by the controlling shareholder. In such cases, gains realized on the sale of shares to the majority shareholder would give rise to full tax. It is unclear as to whether the majority shareholder would qualify for any deduction in respect of the goodwill

element of the purchase price (which would generally correspond to the gain taxable in the hands of the vendor). Even if such a deduction is permitted, however, it would be granted only by way of amortization rather than immediate deduction.

It would seem reasonable, and consistent with the proposed treatment of gains realized on the disposal of shares of a company that has been converted from closely-held to widely-held status, to provide a rollover in the case of the sale of shares of a closely-held company to a widely-held company in exchange for shares of the latter company, and for other forms of merger or amalgamation in which the shareholders of a closely-held company receive shares of a widely-held company in exchange for their interest. The shares of the closely-held company (or its assets in the case of an amalgamation) would have a cost basis in the hands of the widely-held company equal to the cost basis of the shares to the former shareholders of the closely-held company, and the shares of the widely-held company would have a cost basis in the hands of the former shareholders of the closely-held company equal to the cost basis of their shares of the closely-held company.

VALUATION — PARTNERSHIP OPTION

The transitional rules regarding the valuation of shares of closely-held companies that elect partnership treatment are by no means clear. Paragraph 4.79 of the White Paper indicates that such shares would be valued without recognition of unrealized inventory gains or potential recapture of depreciation, and it is understood that no value in respect of goodwill will be recognized in the valuation of shares of such companies.

If no recognition is given to goodwill in such valuations, the full amount of the gain on sale of shares of such a company would be subject to tax (apparently without the transitional relief contemplated in paragraph 5.8 in respect of sales of goodwill within the first 12 years of the new system). This would appear to be entirely unjustified retroactivity. In such circumstances it is questionable whether the shareholder can expect to realize a greater price for his shares on account of the potential amortization of the goodwill element of the purchase price (which does not in any event appear to be assured).

There is no indication as to the intended method of establishing the cost basis of shares of a closely-held company that initially elects to be treated as a partnership, but later becomes taxable as an ordinary closely-held company or becomes a widely-held company.

STOCK OPTIONS

Stock options might well be given preferential treatment, perhaps under rules similar to those in the United States. This procedure is particularly desirable for attracting and motivating capable executives. It can be allowed without any loss of revenue since the benefits granted are not deductible by the corporation.

In any event, gains realized from existing stock options, which cannot be exercised until after a capital gains tax is enacted, should not be taxed at a rate higher than the applicable rate under the present system.

RESIDENTIAL PROPERTIES

We are opposed to the proposal to tax gains made on the sale of residential properties by owners who use such

properties for their own residential purposes. Clearly, such a tax will run counter to the generally accepted belief that as much encouragement as possible be given to Canadians to be home owners.

We recognize that the proposed exemptions respecting gains made in the sale of "principal residences" are designed to avoid tax incidence (which exemptions are dealt with below), but gains made by owners on the sale of their "non-principal residences" are to be taxed even though such properties are nothing more than physically separate extensions of their homes — a summer home is still a home. There is no more justification for a tax on a so-called gain made on its sale than there is on a gain made from the sale of the home-owner's "principal residence".

What we are really talking about here are summer or rural residential properties. Surrounding each of the major urban areas of Canada there are significantly large resort areas made up almost entirely of summer and/or winter homes. The non-incidence of tax respecting their purchase and sale, under our present tax system, permits adequate turnover and concurrent improvement of such properties. We fear that the taxing of such transactions will stultify their marketability and thus have a stagnating effect on the over-all development of such areas. The tax fiscus can be a tax viscous.

How many owners of summer cottages are today involved in changes of job location we do not know. Likely the number is substantial. To tax them on gains made on the sale of such properties does little to help the mobility of our working population and may very well add to business costs since the tax will be looked upon as yet another expense to be borne by the employer in moving employees from one location to another.

If, however, the proposed tax on gains made on the sale of residential properties is to be imposed, we submit that exemptions should not be confined to principal residences. They should be available to owners of residential properties who use them as such, whether or not they constitute a "principal residence." Moreover, we believe that the proposed exemptions respecting principal residences are unrealistic and inequitable. In our view, an annual monetary exemption is bound to be deficient when one takes into account the different market values for the same kind of dwelling in various parts of the country. Instead, there should be a generous annual percentage allowance of the value to the owner on valuation day. In addition, there should be a much less restrictive rollover provision than that provided in the White Paper. All taxpayers should be given the rollover privilege on the sale of residential properties used by them as such so that the proceeds of one such sale are available in full to facilitate the purchase of another personal residence.

Notwithstanding a rising market in the sale of homes, losses can occur. (Houses in the Montreal area have dropped over 9% in value in the last year). Simple justice demands that such losses be deductible to the extent that gains are taxable.

PERSONAL ASSETS

The taxation of gains made on the sale of these assets should be confined, as it is under the present system, to where the seller is a dealer in such assets or originally purchased such assets as a speculator. To tax gains made

on such assets in other kinds of sales is only to invite large-scale evasion by the taxpayer — intended or unintended. This would mean correspondingly extensive enforcement procedures unless such a tax is to fall into disrepute. The costs of such enforcement would be high relative to the amount of revenue at stake and, when added to the book-keeping costs of the taxpayer, will be out of all proportion to the tax to be raised. We say this, notwithstanding the \$500 exemption rule which, we believe, does little to answer the complexities that will arise from the imposition of the tax.

We submit that such assets are properly taxable only for estate tax purposes on their value at time of death.

DEEMED REALIZATION ON DEATH

This brief recommends that the deemed realization of the shares of widely-held Canadian companies every 5 years be dropped and that the distinction between closely-held and widely-held Canadian companies be abandoned. It further recommends that the rates of estate taxes, in

co-operation with the provinces, be progressively reduced.

We believe that the five-year revaluation of shares of widely-held Canadian companies is proposed so that there would be no large double tax (capital gains and inheritance) at death. It is our view that if the distinction between closely-held and widely-held Canadian companies were dropped, the five-year revaluation of the shares of widely-held companies were abandoned and the estate tax rates were reduced progressively to a maximum of, say, 15%, it would simplify administration and maintain an adequate revenue in this section of the system, to require capital gains tax on deemed realization at death in respect of all assets that would otherwise be subject to such tax.

It is further recommended that the amount of capital gains tax payable on deemed realization at death be allowed as a deduction from the corpus of the decedent's estate and that the balance be subject to estate tax at the then reducing maximum rate applicable in accordance with the above recommendation.

Corporations and their shareholders

SMALL BUSINESS

The proposed elimination of the relatively low rate of 21% on the first \$35,000.00 of corporate taxable income is one of the more contentious proposals contained in the White Paper. There is little reason to wonder why this should be so, since heretofore the principle underlying the lower rate, namely, the encouragement of enterprises in corporate form but without corresponding tax disadvantage, has not been seriously questioned.

Admittedly, the lower rate did provide a compelling temptation to those for whom it was never intended to devise corporate structures so as to take advantage of it to the nth degree. The passage in 1963, however, of Section 138A(2), although of doubtful merit on other grounds has, in our view, effectively removed the temptation. In other words, we submit the abuses referred to in the White Paper no longer pertain. Further, we submit that the justification given for the elimination of the low rate on the basis that unincorporated businesses were being discriminated against is not tenable for the simple reason that, save for a few professional groups, there is no barrier whereby proprietors of businesses cannot incorporate. As stated above, the low rate was an intended inducement to incorporate since business hazards, increased by business expansion, are more acceptable under a corporate form.

A valid argument against the 21% rate is its universality respecting corporate income. The object of this rate is certainly not being achieved when it is available to corporations whose status could hardly be described as falling within the ambit of small business — however that term may be defined. Consequently, we agree that the 21% rate should not be available to such corporations.

The after-tax income of a small business is its principal source of capital to enable it to expand. The five-year transition period for the phasing out of the low rate seems an implicit admission that the borrowing power of a small business, permitted by the low rate, is so sig-

nificant that its abrupt elimination would not be tolerable. We submit that the significance of borrowing power to small business will not have decreased over the next five years and will be as vital as ever in the case of the start-up of young growth companies. In the long run, the elimination of the low rate will serve to prevent small businesses from growing, regardless of capabilities of those who are running them. We believe, therefore, that some way must be found to retain the low rate of tax in some cases; otherwise the ability and initiative to enter the economy in corporate form will be lost. Our suggestion is that the rate be retained for those corporations whose taxable income is up to \$35,000.00 per annum, and that the rate be reduced for those with incomes in excess of \$35,000.00. This can be accomplished by reducing the amount eligible for the low rate by 50c for every \$1 of taxable income in excess of \$35,000.00. Thus a corporation whose taxable income is in excess of \$105,000.00 will pay tax at the full rate.

CLOSELY-HELD AND WIDELY-HELD COMPANIES — INTEGRATION

The generalization, to the effect that closely-held companies compete in the small business sector of the economy and that widely-held companies compete in the big business section of the economy, is much too sweeping. There is significant competition between small businesses and large businesses and there are many closely-held companies which are not small businesses.

There should be no distinction between closely-held and widely-held corporations, except that the partnership option should be retained and be available in as many circumstances as feasible. As stated elsewhere in this brief, the quinquennial deemed realization should not be applicable.

The distinction between closely-held and widely-held corporations would result in discrimination and many anomalies. If you have a system which gives widely differ-

ent tax treatment to situations which are similar economically but distinguishable on technical grounds it is not only inequitable but it is certain to produce problems of administration, interpretation and avoidance. The proposed distinctions would also tend to lock in many closely-held corporations, controlled in Canada as well as abroad, and discourage sale of their shares to the public.

The tax credit system for corporate income is sound in principle but costly; moreover, the tax credit proposals contain what are sometimes popularly referred to as "snares and delusions". This arises mainly from the fact that credit is restricted to Canadian corporate tax actually paid. Accordingly, when incentives or reduced rates are given to corporations for any reason, they are washed out on subsequent distribution of the income to the shareholders. Such incentives or reduced rates would provide tax deferment but this would tend to build up taxable surpluses and have a lock-in effect.

A severe example of this is the treatment of capital gains on shares of widely-held corporations which are realized by a closely-held corporation. Such capital gains are only taxable to the extent of one-half when realized (or deemed to be realized) by the closely-held corporation. However, on subsequent distribution to the shareholders the remainder of the gain would be taxed. The total of the taxes on such a gain would therefore be the same as the tax on other types of assets and would be far greater (in many cases more than double) than the tax payable when such a gain is realized directly by an individual. If the proposed system is to be adopted, a minimum revision should be to extend the provision for special distributions now proposed for a mutual fund to all corporations.

The Board suggests two alternative methods by which these problems might be overcome. (Neither of these would be applicable if the partnership option is exercised). One is that the present dividend tax credit system be continued but with the rate of credit raised from 20% to 25%. The other alternative would be that all corporate distributions should be grossed up for corporation tax equal to 1/2 of the distribution. There should then be a tax credit allowed of 1/3 of the grossed-up dividend in the same manner as has been proposed for widely-held corporations. It should be provided, however, that the tax credit should not be refundable and should not reduce the tax otherwise payable by more than would be payable if none of the income were dividends from Canadian corporations.

In order to avoid the consequence that tax incentives or special rates granted to the corporation be nullified on subsequent distributions and taxable surpluses built up, these alternative proposals of ours should apply without regard to the amount of tax actually paid by the corporation. This would incidentally eliminate a lot of record-keeping and administrative problems in keeping track of creditable tax and various types of surplus in corporations.

The provision for flow-through of a credit for foreign withholding taxes is imaginative and well conceived. Under the foregoing proposal this flow-through would not be necessary for resident shareholders of Canadian companies, but it could still apply to distributions to non-residents.

Inter-company distributions between Canadian companies should be tax-free. This would mean that any

special incentives or lower rates given to a corporation would not be lost on subsequent distribution. This would be feasible since under our suggestion the gross up and credit alternative would apply regardless of the corporate tax paid and it would therefore not be necessary to keep track of corporate tax credits passed on by one corporation to another when distributions are made.

THE 2½ YEAR RULE

If creditable tax with reference to tax actually paid is implemented, we believe the 2½ year limit for its distribution is unnecessary.

The White Paper states it is necessary to require creditable tax to be paid out within 2½ years from the end of a corporation's taxation year in order:

- (a) to limit the amount of outstanding claims against the government; and
- (b) to limit the amount of creditable tax in any given corporation at any given time and so reduce the temptation for taxpayers who cannot make use of the creditable tax to sell it to taxpayers who can make use of it.

LIMITING THE AMOUNT OF OUTSTANDING CLAIMS

On the assumption that the distinction between widely-held and closely-held Canadian companies is maintained, refunds would be due to shareholders of widely-held companies whose marginal rate is less than 33 1/3 per cent. The marginal rate becomes 33.28 at \$5,000.00 of taxable income. In order to refund 5 percentage points of tax, the taxpayer's taxable income (including the grossed-up value of the dividends) could not exceed the \$3,000.00 - \$4,000.00 range. It seems unrealistic to expect substantial refunds to shareholders in these income ranges. Therefore, the 2½ year rule will not affect the claims outstanding from shareholders of widely-held companies.

In the case of closely-held companies, no shareholder would incur additional tax as a result of receiving either stock or cash dividends so long as there is creditable tax in the paying corporation once the top personal rate reaches 50 per cent. Since the higher income shareholders really have nothing to lose by declaring dividends from closely-held corporations after the five year transitional period, they can be expected to yield to the demands of shareholders whose rates are below 50 per cent for immediate distributions. Again, one would normally expect such distributions as income is earned. Therefore, the 2½ year rule would not affect the claims outstanding from shareholders of closely-held companies either.

SALE OF CREDITABLE TAX

The second reason given by the government for the 2½ year rule is that it would prevent shareholders who cannot use creditable tax from selling it to others who can. This could not be a problem of any magnitude insofar as widely-held corporations are concerned since the high personal rates proposed would prevent any widespread sale of creditable tax. For example, if a shareholder, who is single with no other deductions and earned income of only \$2,000.00, receives a cash dividend of \$3,000.00, he would be required to gross it up to \$4,500.00. After taking his personal exemption of

\$1,400.00 plus the \$100.00 standard deduction and the 3% employment expense allowance, he would have taxable income of \$4,940.00 on which the tax would be \$1,313.00. After taking credit for the \$1,500.00 creditable tax, this taxpayer would receive a refund of \$187.00. The return to the taxpayer in this example is composed of the \$187.00 refund he receives plus the tax he would have had to pay on his employment income — a total of \$283.00. Such a return probably would not cover the expenses incurred in purchasing the stock. Sales of creditable tax by shareholders of widely-held corporations, therefore, do not appear to pose a problem.

The shares of a closely-held corporation could be the vehicle by which large amounts of creditable tax could be transferred. However, we believe that such transfers would not make economic sense in the case of sales by resident sellers. This, we submit, is well illustrated in the Appendix to this brief.

The sale of creditable tax by non-resident owners of closely-held Canadian corporations to resident individuals could pose a serious problem if there were no special rules governing these situations. Paragraph 6.45 of the White Paper shows how a Canadian resident individual could purchase such creditable tax, wind up the corporation, and receive a refund of creditable tax from the government. Paragraph 6.46, however, goes on to show that so long as the non-resident vendor is taxable on his capital gain in Canada, the government receives exactly the right amount of tax. This is because the tax collected from the non-resident on his gain on the sale of the shares offsets the refunds collected by the resident purchaser of the creditable tax. If there were no deterrent to the sale of creditable tax by non-residents, there would be a serious leak and an intolerable inequity in the system. The taxation of capital gains made by non-residents on the sale of shares of closely-held companies is one way to ensure the government receives its fair share of tax. If such capital gains are taxed the 2½ year rule adds nothing to the effectiveness of the tax system.

CONSEQUENCES OF THE 2½ YEAR RULE

If the rule were implemented, the following unfortunate consequences would likely ensue:

1. The rule would unnecessarily complicate the conduct of small businesses without sophisticated accounting and tax knowledge. The government has stated that the 2½ year rule will be supplemented by an 18 month rule for tax collected on acceptance of a reassessment. Taxes paid on unsettled reassessments will be held in suspense until the dispute is resolved, after which the 18 month rule would apply to any creditable tax resulting from the settlement. Some of the taxes paid would be non-creditable because of the

recapturable depreciation provisions, the goodwill provisions, the entertainment expense provisions, or because of provincial tax rates which cause the corporate rate to exceed 50 per cent. Entrepreneurs without the necessary formal accounting and tax training would find such a series of time limits impossible to apply without considerable professional, legal or accounting assistance. Even those with a reasonable understanding of the system will feel wary about this operation because an error in the declaration of a dividend could result in the loss of credit for an entire year's taxes.

The White Paper is concerned with increasing the respect of taxpayers for the tax system. However, a tax system which contains such unnecessary complications with harsh penalties for those who fail to master the intricacies cannot obtain the respect of the general public.

2. The time limit would force the payment of stock dividends in those cases where the corporation did not have available sufficient funds to declare a cash dividend. Such dividends would be paid in redeemable preferred shares rather than common shares because common shares could not be redeemed without a formal reduction in capital. However, the White Paper states that the partnership election will be available only where there is a single class of shares (White Paper, paragraph 4.23). Thus a corporation which had previously declared preferred stock dividends because of the time limit on creditable tax, could not avail itself of the partnership election until it had redeemed all its preferred shares. This could work an unfair hardship on many small taxpayers.
3. The rule would force the rate of taxation of corporate profits in certain closely-held companies to reach or exceed 60 per cent in 1974. This is because mid-1974 would be the deadline for distribution of creditable tax earned in 1971. However, by 1974 the personal rates would still be in the transitional period. This is nothing short of a penalty, without justification, for taxpayers in those circumstances. Moreover, the taxation of corporate profits at such rates appears unwarranted when one considers that in developed countries generally the tax rate on corporate profits is well below 50 per cent.

We believe the proposed rule, which requires creditable tax to be paid out within 2½ years from the end of a corporation's taxation year, is both unnecessary and unduly harsh for many small businessmen. It seems to us that the 2½ year rule will not increase the effectiveness of the tax system; moreover, the unfavourable consequences which will result from the operation of the proposed rule argue forcefully for its non-adoption.

Business and property income

THE NOTHINGS

Generally, we support the proposal that "nothings" are to be depreciable. Some indication should be given of which expenditures are to be in this class. However, we do not believe that goodwill should be included.

The proposed treatment of goodwill is anomalous. It arises from the idea that goodwill is a "nothing" and should be written off by a purchaser. It assumes that because of this the price for goodwill in future will be inflated and it is therefore proposed to tax the vendor on

an arbitrary basis. This will pose very difficult problems in allocation of prices for assets sold, and will create severe anomalies as between sales of assets and sales of shares of a company. A vendor may be taxable on the sale of goodwill where he has actually incurred a loss on the sale or where the sale price is established under a pre-existing contract.

In our view goodwill is not really a "nothing" at all because it is an asset which does not depreciate through use. In this respect it is somewhat akin to land. As the White Paper points out, it must be kept up. However, this creates no tax problem because the cost of keeping it up is taken into account in computing income. We suggest that goodwill should be treated as proposed by the Royal Commission and should not be depreciable. Any gain or loss should be treated in the same way as any other capital gain, to ensure consistency of treatment and to avoid anomalies.

We are particularly concerned with the treatment of these intangible assets at valuation date and the transitional provisions proposed. Thousands of shareholders of closely-held corporations will find themselves faced with a tax on already existing goodwill values (as opposed to those taxpayers investing in shares of widely-held corporations who will, by using market values on valuation day, automatically exclude from tax the current value of goodwill). Similarly, many small businessmen, particularly those in the professions, will find that by reason of the definition and transitional provisions, they are faced with the payment of a tax on an asset which they have actually purchased and paid for with after-tax dollars.

ENTERTAINMENT AND RELATED EXPENSES

The Board believes that the proposals to deny deductions across-the-board for entertainment expenses, the cost of attending or sending employees to conventions, and the cost of dues for membership in social or recreational clubs are too stringent. Many expenditures of this type are essential to the conduct of today's business. The approach for limiting such expenditures should be based on reasonableness. It is noteworthy, we think, that the Department of National Revenue has not been unsuccessful in its reliance on the combined effect of section 12(1)(a),(h) and (2) of the Income Tax Act when disputing claims respecting entertainment and related expenses.

DEPRECIATION

The proposal that a loss from depreciable property cannot be set off against other income, if such loss is equal to or less than the capital cost allowance plus any interest and taxes on such property, is unduly onerous.

We are not satisfied that investors in such property are using the existing depreciation provisions in order to have

a tax holiday. Generally, these investors ultimately pay their fair share of tax, save, perhaps, in those cases where the investor in rental real property "trades up" such property and thereby defers tax on recaptured depreciation. This could be avoided by adoption of the proposal that each such property be placed in a separate depreciation class provided the interest of the investor in that property exceeds \$50,000.00.

INVESTMENT INCOME OF CLUBS AND OTHER NON-PROFIT ORGANIZATIONS

If the proposal is implemented to tax the investment portfolio income of clubs and other non-profit organizations, the Board believes that expenses incurred to earn such income should be deductible. Furthermore, income tax should be computed at the personal rate schedule in the same manner as trusts.

TRUSTS

To facilitate comment, we would break trusts down into two broad categories: Investment trusts and Family trusts. Investment trusts closely resemble mutual funds with the assets being held and managed by a trustee for the benefit of unit holders. Family trusts are created either *inter vivos* or under a will and usually involve property settlements for the benefit of the immediate family of the settlor or testator. Estates of deceased persons would fit into this latter category.

For taxation purposes the conduit principle has hitherto applied with respect to income arising out of investment trusts. The Board sees no real objection to their proposed treatment as corporations for tax purposes, provided the creditable tax as well as foreign tax where applicable, are passed on to the unit holders or beneficiaries.

The Board is strongly of the opinion that the conduit principle (Section 63 of the Income Tax Act) should continue to apply to the income of family trusts. We are disturbed by the proposal to subject the accumulated income of these trusts to a flat rate federal tax of 40% which when combined with applicable provincial taxes would increase the overall rate to at least 50%. Unlike corporations or investment trusts, it is not possible to vary or wind up the majority of family trusts now in existence so as to lessen the impact of the harsh tax treatment proposed.

Furthermore, as we understand the proposals in paragraph 5.57, none of the tax paid on accumulated income will be creditable to the beneficiaries either at the time it is paid or on distribution of the assets. For these reasons we regard the proposals for taxing accumulated income as highly inequitable and urge that this matter be reconsidered. To this end we recommend that there be a study in depth of the whole subject of the taxation of trusts.

International income

NON-RESIDENTS

It is a fact of life that no country can live in isolation from its neighbours and, particularly in Canada, we cannot develop without the new capital and retained earnings of non-residents. The proposals provide a two-pronged danger to foreign capital.

First, Canada's investment climate is rendered less attractive by the higher government expenditures implicit in the proposed higher tax yields.

Secondly, an international tax barrier would be established by the increase in taxation of non-residents to rates in excess of those in the non-residents' home countries.

There seems little reason to believe that foreign capital will continue to come to Canada to the extent required in the face of higher taxation, when there are lesser-taxed environments which are equally secure, stable and investment in which conforms with the investor's government policy.

SIGNIFICANCE OF FOREIGN INVESTMENT

External capital has always played a significant role in Canadian development. Indeed, scarcity of such capital has often put limits on the pace of Canada's expansion.

This is particularly noticeable in the development of Canadian resources; for example the discoveries and production of oil and uranium, the massive investments in iron ore, mining and the enlargement of the base metal, pulp and paper industries.

DEBT CAPITAL

Care must be taken to retain in Canada the proceeds and profits derived from our resources. This requires that the major proportion of foreign capital, in prudent balance with equity, be recruited as debt capital. However, withholding taxes on debt obligations restrict Canadian borrowers in obtaining debt capital. The government has recognized this by waiving this tax on interest paid by all levels of government and their crown corporations. The government has also from time to time issued tax remission orders to power companies and others where otherwise the sale of a very large issue of bonds in the United States might be impossible or the interest rate would be unduly high.

As in other parts of the world, many Canadian borrowers find that they have to indemnify foreign lenders for taxes which are not recoverable in the lenders' own country. Where claims are made, the effective interest rate is increased.

The principal reason for interest having to flow tax-free is that the particular foreign institutional investors pay very little, if any, tax in their home country. We therefore recommend that the government should seriously consider repealing the non-resident's withholding tax on interest payments to the widest extent possible. In general it should be repealed for all institutional payees where it is in the public interest to do so. Another approach would be for the withholding tax, in treaty circumstances, to be reduced to the same rate of tax as is applicable to the Canadian interest on its receipt in the foreign country.

We doubt that implementation of either of these suggestions would significantly reduce revenue since the total withholding tax from *all* types of income yields just in excess of \$200,000,000 or around 2% of all revenues.

DIRECT INVESTMENT

At first glance it might be thought that the proposals respecting non-residents are neutral since it is not proposed to change the tax on dividends in most cases. However, the introduction of a 50% capital gains tax rate will have a marked effect.

The existing tax rate applicable on distributed earnings of wholly-owned Canadian subsidiaries of non-resident parents is just over 60% (corporate rates plus withholding tax). This exceeds most home country taxes and the excess is a non-deductible, additional expense of doing business in Canada. It can be compared with the reci-

ipient's home country rate of 52.8% (soon to be reduced) in the U.S. and 45% in the U.K. However, at present there is the compensation that capital gains are not taxed.

Now it is proposed that for Canadian taxpayers the base should be broadened to include capital gains and in compensation the corporate and shareholder taxes should be integrated and limited to 50%. Yet for non-residents no such integration or limit is to apply. The base is to be broadened but the tax rate is to stay high. For residents of non-treaty countries the rate is to be increased to 64%. We point out that the O.E.C.D. model suggests a maximum combined rate of 55% (on the basis of a Canadian corporate rate of 52%). Nor should it be forgotten that the opportunity to defer the withholding tax by retaining earnings in Canada is little incentive for *new* investment if the ultimate tax is too costly. Our suggestion for the elimination of this obstacle to direct foreign capital investment in Canada is that the government adopt a treaty principle which would restrict the Canadian combined rate of corporate and withholding tax to the greater of the Canadian corporate rate (proposed as 50%) and the corporate rate in the recipient's country.

The proposal that gains realized by non-residents on the sale of shares of closely-held Canadian companies be made subject to Canadian tax is to be enforced by provision for "certificates of compliance" in respect of transfers of closely-held company shares (6.46). There is, however, no indication as to the government's intention with regard to the capital gains tax in the re-negotiation of treaties that provide for exemption in respect of such gains, nor is there any indication of what the tax position will be for a Canadian resident who acquires shares from a non-resident who was entitled to treaty exemption.

CARRYING CHARGES

In judging the impact of the current 15% withholding tax on most forms of income flowing to non-residents it is necessary to take into account the carrying charges being spent to earn the income. Thus if part of the funds for a holding of bonds were borrowed and the carrying charges amounted to 50% of the income then the 15% withholding tax amounts to 30% of the profit.

For a non-reciprocating country it is now proposed to increase the withholding rate to 25% which would give a 50% impact in the above example. If the carrying charges were higher, the 25% Canadian withholding tax on the gross interest might exceed the non-resident's home country tax on the net interest income and thus a full tax credit would not be available. Therefore, in our view, it is a necessary corollary of increasing the withholding rate that the non-resident should have the opportunity to deduct the applicable expenses. The precedent for this is the alternative for non-resident landlords to file a Canadian tax return, paying tax at resident rates on net Canadian rents. This alternative could be made available to any type of Canadian income flowing to non-residents.

FOREIGN INCOME OF RESIDENTS

EXPORT ENCOURAGEMENT

It is recommended that the details of both treaty and non-treaty systems allow growth opportunities for Canadians to sell abroad where foreign competition dictates local incorporation.

LESS-DEVELOPED COUNTRIES

It is also recommended that similar reinvestment opportunities be available to help poorer countries in the world in which we live. The encouragement of lower local taxes for Canadians willing to take the risks should not be nullified by Canadian taxation.

CANADIANS WORKING ABROAD

While a quinquennial revaluation only seeks to force a tax on portfolio investments, the act of leaving the country forces a capital gains tax on all assets. This would be a hardship on those whose promotion requires working abroad for a few years. Canadian citizens should have the option to file as residents in regard to Canadian source income during their absence abroad.

TREATY ADMINISTRATION

While a swing towards a complex web of varied tax treaties is not a happy prospect, it might serve a temporary purpose. Each government is bargaining for a higher rate of tax on income at source to the detriment of the tax rate in the recipient's country of residence. Each is also seeking to use to its best advantage its rules for allocating income between the countries. The taxpayer suffers while the battle goes on overhead. Increased sophistication in the bilateral tax treaties should eventually result in common rules being drafted into domestic legislation with universal application and greater certainty.

In this connection it is hoped that the rules governing sales, mergers and re-organizations for non-residents will not be as cumbersome as those in the U.S., and that an advance ruling procedure will be available.

Appendix

Liquidation of a closely-held corporation by a resident seller.

Facts: A closely-held corporation was formed 10 years ago with \$50,000.00 capital. In the next 10 years it earned \$500,000.00 on which it paid tax (all creditable) of \$250,000.00. No profits have been distributed and, in order to strip the corporation of its creditable tax, the owner has converted all the assets into cash. The balance sheet therefore is as follows:

Cash	\$300,000.00	Capital	\$ 50,000.00
			<u>250,000.00</u>
			<u>\$300,000.00</u>
Creditable Tax			<u>\$250,000.00</u>

The owner has the following alternatives open to him:

Alternative 1

Pay out all the cash as a dividend to himself as follows:

Dividend plus creditable tax	\$500,000.00
Tax @ 50%	250,000.00
Less tax credit	<u>(250,000.00)</u>
	<u>Nil</u>
Net cash dividend	\$250,000.00
Return of capital	<u>50,000.00</u>
Net cash to owner after tax	<u>\$300,000.00</u>

Alternative 2

Sell the shares to someone who cannot use creditable tax (such as a non-resident) before making distribution. The most anyone would pay would be slightly less than \$300,000.00, so assume that \$300,000.00 is received

for the shares (cost basis \$50,000.00).

Cash received on sale	\$300,000.00
Less capital gains tax (50% of \$300,000.00 - \$50,000.00)	<u>125,000.00</u>
Net cash to owner after tax	<u>\$175,000.00</u>

Obviously this alternative is less desirable than Alternative 1.

Alternative 3

Sell the shares to resident individuals who have no other source of income. Because they can use the creditable tax they can pay a higher price to the owner. The maximum they would pay can be calculated as follows:

Cash in company	\$300,000.00
Creditable tax	<u>250,000.00</u>
	<u>\$550,000.00</u>

For tax purposes, they would have a loss of \$500,000 on the shares which is deducted from the \$500,000 dividend.

However, even if the owner received \$550,000.00 his after tax return would be:

Cash from sale	\$550,000.00
Less capital gains tax on \$500,000.00 @ 50%	<u>250,000.00</u>
Net cash to owner after tax	<u>\$300,000.00</u>

Thus the owner gets the same amount as in Alternative 1. Since Alternative 1 would involve relatively little in expenses compared to Alternative 3, it can be expected that taxpayers will choose to distribute dividends rather than selling creditable tax.

APPENDIX "C"

comments on proposals for tax reform

Submission to
The Senate Standing Committee on
Banking Trade & Commerce



THE MINING ASSOCIATION OF CANADA, MAY 1970

THE MINING ASSOCIATION OF CANADA

SUBMISSION
CONCERNING PROPOSALS FOR TAX REFORM
AFFECTING THE CANADIAN MINING INDUSTRY

April 14, 1970

THE MINING ASSOCIATION OF CANADA

SUBMISSION CONCERNING PROPOSALS FOR TAX REFORM AFFECTING THE CANADIAN MINING INDUSTRY

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INTRODUCTION AND SUMMARY

The Association

The Mining Association of Canada is the recognized national organization of the metallic and non-metallic sections of the Canadian mining industry. It is composed of companies engaged in mineral exploration, mining, smelting and refining who account for more than 95% of Canada's output of metals and major industrial minerals. The Association's main aim is to express the views of the industry on a national scale and to co-operate with the responsible departments of government in the development of policies affecting exploration, mining and processing, and the development of mineral exports.

The Principal Issue

The White Paper contains a great many proposals that would affect the Canadian mining industry and the economy generally. However, this submission is concerned primarily with the proposals for the substantial withdrawal of major tax incentive provisions presently available to the Canadian extractive industries, and with the implications this would have for the future development of the Canadian economy.

The broad issues are quite easily stated. Essentially they involve two fundamental questions:

- 1) Would the changes proposed in the White Paper have any major impact on the long-term development of the mineral industry in Canada, and
- 2) If so, would this have a beneficial or detrimental effect on the Canadian economy and on regional development.

It is to these questions that the Association wishes to direct attention. The issues involved are exceedingly important for Canada, and the consequences of serious misjudgement on either point could be devastating. Although we believe the White Paper proposals would have a profound effect on the Canadian mining industry and the economy generally, it is not likely that the full impact of this would become clearly apparent for some considerable time. Certainly it would take many years of corrective action to repair the damage.

The mining industry is endeavouring to take an entirely objective approach to this subject, and trusts its views will be considered in that light.

Two points should be noted in this connection:

- 1) Those engaged in the mining industry are in the best possible position to assess the probable effects of the proposed tax changes on future levels of exploration and on the development of new mines.

- 2) While most of those who have substantial investments in existing mines would be adversely affected by the proposals, the transitional provisions would provide varying degrees of relief against an immediate loss in values. By far the most important effect of the proposals would be to divert new investment from mineral exploration and development in Canada to other parts of the world. Therefore, it is the Canadian economy generally, not the present participants in the mining industry, that would suffer the consequences of this diversion of exploration and mining capital.

Scope of this submission

In this submission, the Association has not attempted to deal exhaustively with every aspect of this important subject. Many other submissions will be made by individual companies and groups in which the effects of the White Paper proposals in specific circumstances will be adequately explained. The present submission seeks to draw attention to the principal questions that must be resolved in the hope that this will provide a broad framework within which other more detailed submissions can be related.

The matters covered in the various sections of this submission may be outlined briefly as follows:

I CONTRIBUTION OF THE MINING INDUSTRY TO THE CANADIAN ECONOMY AND TO REGIONAL DEVELOPMENT

This first section reviews the impressive record of growth in production and productivity achieved by the Canadian mining industry since World War II based on the stimulus provided by the present favourable tax provisions. It notes the importance of this growth to Canada's exports and balance of payments, provision of new employment opportunities, development of secondary and service industry and reduction in costs of power and transportation facilities. The effect of new mining projects on vast areas of Canada that have little, if any, other prospect of economic development is also discussed.

These benefits are difficult to quantify. It is equally difficult to assess the cost of the tax incentive provisions in terms of tax revenue forgone. This involves speculation as to the level of mining activity that would have been achieved if the incentives had been materially reduced. Without any precise measure of the benefits or of the costs it is necessary to rely on the exercise of reasonable judgement in the light of the evidence that is available. From this it must be

clear that the present incentive provisions have generated a large volume of highly productive investment, mainly in less developed areas that have little if any alternative investment opportunities. This has not had the effect of drawing scarce labour and capital from other productive uses in Canada. Rather, the rapid growth of the mining industry has benefited all sectors of the economy, attracting new investment to processing and fabrication facilities to the producers of mining equipment and supplies, and to other manufacturing and service industries.

II CONTRIBUTION OF THE PRESENT TAX INCENTIVE PROVISIONS TO THE GROWTH OF THE CANADIAN MINING INDUSTRY

This section of the submission outlines the role of the present tax incentive provisions and examines the way in which they have influenced the level of exploration in Canada for new mineral deposits and the development of discovered deposits into new mines. It also provides some indication of the magnitude of the effect of the new mine exemption and depletion allowance provisions on the potential reward for successful exploration, and on the prospective rates of return from capital expenditures required to bring a new mine into production. The studies that have been made demonstrate that without these provisions the value of a new mineral discovery would be greatly reduced materially (and in many cases virtually eliminated) and that the prospective rate of return from the development of a new mine would frequently be inadequate to attract the required capital.

III OUTLOOK FOR THE CANADIAN MINING INDUSTRY

This section draws attention to a number of important developments in other parts of the world that will affect the prospects for future development of the Canadian mining industry. The prospects for major new mining ventures in Australia, Africa and Latin America, and developments in cheap ocean transportation facilities for bulk cargoes are of considerable importance in this connection. The increasing cost of locating new ore reserves in Canada, and the chances of success in finding major deposits in Canada compared with other countries will also affect future levels of exploration work in Canada, apart altogether from changes in the relative weight of taxation. This would be further aggravated by a substantial withdrawal of tax incentives in Canada in the absence of any similar action on the part of other mineral producing countries.

Reference is made to the shortfall of new discoveries in relation to the rate of development of known deposits. This underlines the importance of maintaining powerful and effective incentives to promote continued mineral exploration in Canada on a major scale.

IV EFFECT OF THE WHITE PAPER PROPOSALS ON EXPLORATION AND DEVELOPMENT OF NEW MINES

This section reviews the results of studies made of the effect of the White Paper proposals on the incentive to explore for minerals in Canada and on the economics of new mine development. This indicates clearly that the proposals would virtually eliminate the incentive element in the present provisions and would dramatically reduce the value of new discoveries. The effect of the proposals on the incentive to expand production or prolong the life of existing mines is also discussed.

There is, of course, no way in which to make a precise forecast of the extent to which the proposed changes would be reflected in reduced levels of exploration activity, lower rates of new mineral discovery, and new mining and processing projects foregone. However, there is little doubt that the effect on the economics of exploration and new mine development would be far greater than could be absorbed without more than a minor reaction. In fact, their effect on values of discoveries and prospective rates of return are of such significance as to suggest that the longer-term reaction might be disproportionately great.

In this section, we also refer to possible modifications that might be made to the present provisions with a view to reducing their cost without material loss of effectiveness. The new-mine exemption provision might be altered so as to bear some relationship to the investment required to develop the new mine. Depletion allowances might be made more effective by calculating the allowance by reference to profits determined before rather than after deduction of exploration and development expenditures. If the White Paper concept of "earned" depletion were to be adopted, this could take the place of part of the present percentage allowance as a means of providing incentives, while retaining a lower basic percentage allowance to compensate for provincial mining taxes and other special factors affecting mining activities.

V COMMENTS ON OTHER WHITE PAPER PROPOSALS AFFECTING THE MINING INDUSTRY

This section deals with three additional aspects of the White Paper proposals that have particular significance to the Canadian mining industry:

(1) Corporations and shareholders

The proposed system of gross-up and credit in respect of inter-company dividends would seriously interfere with movements of surplus funds from one company to another. This problem would be particularly severe for companies in the mining industry.

Integration of personal and corporation tax in the manner proposed would also have the effect of nullifying the benefit of any tax incentives made available at the corporate level so far as Canadian shareholders are concerned. This would weaken the effectiveness of the incentives, and is undesirable from the point of view of Canadian ownership of resource industries.

Other objections to the complex integration proposals are also briefly noted. It is strongly recommended that the present exemption for inter-company dividends and the 20% dividend tax credit be retained.

(2) Capital gains

While concerned that taxation of capital gains will have a detrimental effect on the future growth of the Canadian mining industry, special attention is directed to the severity of the White Paper proposals, particularly in relation to the treatment of capital gains in the United States. Canada should not impose tax at ordinary rates on more than one-half of any type of capital gain, and should eliminate death duties with the introduction of capital gains tax. The five-year revaluation proposal affecting shares of widely held companies should be dropped.

(3) International income

Comment is made on the complex proposals designed to prevent avoidance of tax on income derived from tax haven operations, and the problems to be anticipated in negotiating the tax treaties on which the proposals would depend.

CONCLUSIONS

In this submission the Association has endeavoured to outline briefly the grounds for its serious concern over the long-term implications of the White Paper proposals relating to the extractive industries, both for the future of the Canadian mining industry itself, and for the economy generally.

The conclusions to be drawn may be summarized as follows:

- (1) The present tax incentive provisions have proved to be remarkably effective in stimulating mineral exploration and the development of a wide range of new mining ventures in Canada.
- (2) The substantial withdrawal of major incentives proposed in the White Paper would materially affect the economics of exploration and development of new mines in Canada, resulting in fewer new discoveries, and greatly reduced investment in new mining and processing ventures.
- (3) Reduced levels of mining activity in Canada would seriously impair the rate of growth of the whole economy through its effect on direct and indirect employment, on the cost of raw materials to other Canadian industries, on the development of processing and fabrication facilities, on other manufacturing and service industries, and on Canada's imports, exports and balance of payments.
- (4) The prospects for the development of vast regions offering little alternative economic opportunity would also be adversely affected.
- (5) The present outlook for the Canadian mining industry is in any event less encouraging than it has been in the past due to new mineral discoveries in other parts of the world and improved transportation facilities.
- (6) In the light of the above points, it would be foolhardy in the extreme for Canada to risk serious damage to its economy in order to achieve a short-run increase in tax revenue from existing mining operations.

The Association fully appreciates that the present incentive provisions are not perfect in every respect, and that some modifications might be devised to improve their effectiveness without increasing cost, or to reduce their cost without material loss of effectiveness. However, the basic issue at the present time is the question of the need for mining tax incentives in the general order of magnitude of those presently in effect. Discussion of details of form and approach would serve little purpose until decisions have been made on this basic issue.

I THE MINING INDUSTRY'S CONTRIBUTION TO ECONOMIC GROWTH AND REGIONAL DEVELOPMENT

Growth of the industry since World War II

Since 1946, the rise in output of the Canadian mineral industries has been outstanding. From some \$502 million in that year, representing 4.2% of the Gross National Product, the value of output rose nearly ten times to reach \$4,687 million in 1969, or 6% of the Gross National Product. Excluding petroleum and natural gas, it rose from \$475 million to \$3,278 million over the same period, almost a sevenfold increase. (See Appendix B. Table 1).

The major products associated with this growth are asbestos, copper, iron ore, lead, molybdenum, natural gas, nickel, petroleum, potash, silver, sulphur and zinc. Uranium output rose substantially in the period, but subsequently declined. Of the major minerals, only gold and coal have failed to share in the growth, and with respect to coal, new developments in Western Canada now promise to improve its prospects.

Measured in volume terms, industry output recorded an average annual growth rate of 8.1% from 1946 to 1969, compared with a 4.7% growth rate for the economy as a whole (as measured by the real domestic product). However, the rate of growth in this period has not been constant; from 1961 to 1969, the average annual growth rate of the industry fell to 5.5%, just equalling the growth rate of the economy generally in this period.

Export performance

In its Fourth Annual Review published in September 1967, the Economic Council of Canada, which had on previous occasions highlighted the export performance of the Canadian mining industry, referred to the importance of resource-based industries in Canadian export trade as follows: (p. 231-2)

"The resource-based industries have had in the past, and continue to have, a more important part in Canada's economy than in the economies of most other developed countries. Their value of output is high and they are the basis of large secondary and tertiary industries. Also, the products from these primary industries make up the bulk of our exports; they have continued to account for over four-fifths of the total value of Canadian exports over recent years . . . "

"The exports of the primary industries and the competitive position of these industries in international trade continue to be of major importance in the maintenance of a viable balance of payments."

The value of exports of metals and minerals and their semi-manufactured products (excluding primary iron and steel, aluminum and its products) was \$2,946 million in 1969, about six times higher than in 1950. This represented 20.4% of all merchandise exports against 20.2% for forestry products and 9.7% for agricultural and fish products. In 1950, the comparable ratios were, respectively, 15%, 34%, and 30%. Excluding petroleum and natural gas, the value of exports of metals and minerals and their semi-manufactured products was \$2,244 million, about 4½ times the 1950 level. (See Appendix B. Tables 2&3) In addition to its contribution to exports, the industry has played an important part in the development of strong primary iron and steel and other industries.

The breadth and diversity of Canada's mineral markets is demonstrated by the fact that Canadian asbestos is sold in 84 countries, copper in 75, zinc in 42, nickel in 38, lead in 24, sulphur in 21, magnesium in 20, molybdenum in 17, iron in 15, cobalt in 14, potash in 13, silver in 9, cadmium in 6, and uranium in 3. Canada leads the world as a producer of nickel, zinc and asbestos, and ranks as second largest producer of lead, molybdenum, potash, silver, titanium ore and cadmium.

The one area where growth of the industry has not been commensurate with output is in its addition to ore reserves. Discoveries of new viable deposits have been rather slow since 1960 in spite of current annual exploration expenditures of over \$97 million per year.

Capital Expenditures

Turning to the inputs of resources used by the mining industry, the most notable feature is high capital expenditure. In 1946, new capital expenditure in mining was some \$27 million, about 1% of total new public and private capital expenditure. Preliminary estimates for 1969 indicate that spending by the mining industry had risen fortyfold to \$1,083 million, or 6.2% of the total of such spending in the economy.

Productivity

This rapid expansion in capital investment has been reflected in the industry's productivity performance: output per man in mining has risen from 1946 to 1967 at a rate three times that of the economy as a whole and double that of manufacturing. In an address to the Canadian Institute of Mining and Metallurgy in 1967, the present Chairman of the Economic Council, Dr. A. J. R. Smith, commented on productivity and the mineral industries as follows:

- (1) Productivity is relatively high in this sector of the economy in relation to other major sectors of the economy, and has apparently been tending to increase more rapidly than in many other sectors over the post-war period as a whole.

- (2) The recent average level of productivity in the minerals sector of the Canadian economy is roughly equal to, if not slightly above, that in the minerals sector of the U.S. economy. This is perhaps the only major sector — certainly the only major goods-producing sector — in which the average level of productivity in Canada measures up well with that in the United States.

Employment in the mining industry in 1968 was some 28% above the 1949 level.

Contribution to the General Economic Growth

The fast rate of growth of the mineral industry has been a significant factor in promoting the expansion of the whole economy. More particularly, the high volume of exports of the industry has made a substantial contribution to the Canadian balance of payments, providing the foreign exchange needed to pay for the imports of goods and materials essential to Canada's growth. It is estimated that after allowing for interest, dividends and imports of mining equipment and supplies, the net foreign earnings of the mining industry amount to some \$1,500 million per year.

The impact of mining's high and rising demand for goods and services on the growth of supplying industries has been considerable. In addition to the high level of new capital expenditure already mentioned, there is a substantial repair expenditure on construction and machinery and equipment of about \$283 million on average per annum over the past four years. Some specialized equipment must be imported, but it is estimated that about 80% of all the industry's capital requirements for machinery as well as almost all of its operating supplies and services are purchased in Canada.

Furthermore, purchases of fuel, power, iron and steel products, chemicals and other supplies are equivalent to about 30% of the industry's gross value of production and have grown along with mining and related equipment. The railways have similarly benefitted from rising output, since mine products represent about 40% of all railcar loadings. The effect of this high basic load is to reduce transport costs for all.

Mining has been of great importance in providing raw materials for secondary industries. The prime example is iron and steel which, based on domestic ore, is one of the few Canadian manufacturing industries to become internationally competitive. The smelting and refining operations which have developed near many mines are also of significance. The value of their shipments in 1967 was \$862 million. Further processing of domestic materials, such as fertilizer manufacture from potash, and copper fabrication, have developed strongly under the impetus of an expanding mining industry.

The effect of mining activities on employment goes far beyond the direct employment of about 115,000 workers with an annual payroll of \$900 million. Not only does the industry itself generate substantial employment in other industries through its consumption of goods and services, but the spending of its workers also creates jobs. A recent study of a new mine in British Columbia estimates that for each new primary mining job there will be one supporting service job in the immediate locality and about six new jobs elsewhere in Canada. *

Finally, because Canadian mining is large scale, highly productive and internationally competitive, its requirements tend to raise the level of efficiency in industry generally. One example of this is the development by the railways in Canada of unit train operation to serve large mining projects. The lessons learned from these operations will flow through to all bulk commodity transport users. Another effect has been to produce a highly skilled, technologically oriented labour force. Some of the benefits of these skills may be seen in the international successes of Canadian aero-surveying, drilling and prospecting companies.

Thus it is evident that the expansion of the mining industry has provided a powerful stimulus to the growth of the whole economy. The development of secondary industry would not have been as rapid nor as diverse without a strong mining industry.

Contribution to Regional Development

A more balanced regional development is a national goal rating very high priority in Canada. One of the most significant results of mining growth in the last two decades has been its major contribution to the attainment of that goal, and today the great geographic spread of mining activities extends to all regions of the country. (See Appendix C. Map of principal mining areas of Canada).

Mineral growth, spurred by highly successful taxation policies, directly benefits virtually all sections of Canada. Newfoundland, New Brunswick, northern Quebec, northern Ontario, Manitoba, Saskatchewan, Alberta, British Columbia and the far north — all have felt the impact of the growth of iron, lead and zinc, nickel, copper, uranium, potash, oil, natural gas, asbestos and other minerals.

* "The Impact of the Coal Mining Operation of Kaiser Resources Ltd. on the Canadian Economy". Hedlin, Menzies & Associates Ltd.

Significant mining operations in some of the less prosperous areas have provided much needed employment and income earning opportunities. Newfoundland, New Brunswick, Manitoba, Saskatchewan and the Northwest Territories increased their joint share of the national output of metals and non-metals from 11% in 1950 to 22% in 1969.

Additionally, the growth of mineral output has helped many areas in reducing their dependence on one product. Thus, Saskatchewan's mineral output now equals 40% of farm cash receipts. Similarly, the processing of minerals has opened up new opportunities in other regions.

Mining has been especially significant in the development of the North, where in many instances it is virtually the only industry. In many areas, mining has been the pioneer, and transport, power and other facilities required by mining have been used as a base for development of other industries. It is noteworthy that 70% of new railway mileage built in Canada from 1949 to 1967 was built primarily as a result of mining activities.

The mining industry has often provided from its own resources much social capital in the form of roads, power and housing that are normally already available to other industry. Thus, mining companies undertake many of the planning and financial functions of government. The development of the town of Thompson in Manitoba is a prime example; what was a wilderness in 1957 is now the third largest city in Manitoba. Other communities might be mentioned — for example, Buchans, Grande Cache, Esterhazy, Cassiar, Clinton, Schefferville, Labrador City, Wabush and Murdochville, to name a few.

Finally, the contribution of the industry to provincial and municipal revenues is most important. Not only does this improve the provinces' position, but it also reduces the federal government's need to contribute to provincial budgets.

In summary, the industry has grown rapidly — at a faster rate than the economy or the manufacturing industries. Its direct contribution to the Canadian economy in terms of output, exports and employment is considerable. It is a major consumer of the products of many other industries and a major supplier to them. The pace of its growth and its magnitude have aided the growth of the whole economy and assisted regional development. It has also provided many immeasurable benefits, particularly to the less prosperous areas of Canada, as a developer of new territories, a provider of social capital and a technological innovator.

II CONTRIBUTION OF THE PRESENT TAX INCENTIVE PROVISIONS TO THE GROWTH OF THE CANADIAN MINING INDUSTRY

The Association believes that the present tax incentive provisions have played a vital role in promoting the high rate of growth that has been achieved in this important and productive industry. However, the significance of the incentive provisions, and the extent of their influence on exploration and new mine development is not fully appreciated outside the mineral industry.

The role of the incentive provisions

In referring to the existing tax incentives it should be noted that the present law contains a number of provisions affecting the taxation of income derived from mining activities that are designed primarily to compensate for special circumstances applicable to the mining industry as well as provisions that are intended primarily to provide incentive. The special provisions for the deduction of exploration and development expenses and the rates of capital cost allowance provided in respect of mine buildings, machinery, equipment and mine shafts, for example, are clearly required primarily to meet the particular circumstances of this industry. The three-year tax exemption for new mines, depletion allowances and the exemption for prospectors and grubstakers, on the other hand, are primarily intended as incentive measures. Nevertheless, it is important to recognize that, in the absence of the latter provisions, mining activities would bear a higher burden of effective taxation than other industries.

This would result from a number of factors. In the first place, mining profits are subject to substantial provincial mining taxes or royalties. It is of no significance to the mining industry as to whether or not the provincial mining tax is called an income tax, or a duty, or royalty paid to the province as a share of the value of the ore belonging to the province. The over-riding fact is that provincial mining taxes are payments made to the public purse and must be taken into account when revisions to the tax structure are contemplated. Secondly, mining operations generally bear considerable social costs in the form of roads, townsites and other community facilities that are normally financed by provincial and municipal governments. Without some form of relief, successful mining ventures would bear an excessive burden. And this takes into account only the successful ventures. The burden of taxation on the industry as a whole is also affected by the relatively high risk of loss associated with exploration and mine development. Much of the exploration and development work is, of necessity, done by companies that will have income against which to deduct their expenditures only if they are

successful in developing a profitable mine. If all profits of successful ventures are subject to full and immediate taxation, while comparable relief is not assured for all losses, the tax system would impose a higher effective burden on industries involving higher risk than on those where the risk of loss is less.

Risks associated with Mining

Unlike any other, the mining industry is concerned with the discovery, extraction, processing and marketing of a commodity which is exhaustible. Forest industries, for example, can replant trees to ensure supplies for future crops. Manufacturing industries are able to replenish their supplies of raw materials to provide for the continuation of their fabricating operations. But when ore is taken out of the ground, it cannot be replaced. This means that to ensure its continuing supply of raw material the mining industry must not only devote considerable attention to the development of its existing workings and the refinement of mineral processing and other sciences and techniques aimed at maximizing the value of its discovered ore reserves; it must also sustain continuing exploration for new economic orebodies to replenish the reserves from which it draws its raw material supplies. The future of the industry is entirely dependent on its success in meeting this objective.

For the forest and manufacturing industries, continued access to supplies of raw material can be reasonably assured. In the case of mining, however, exploration, besides being extremely costly, cannot be assured of success. It entails the commitment of large amounts of capital to ventures involving an exceptional degree of risk. The inevitable corollary is that compensation has to be commensurate with that unusually high risk. If it is not, capital will hardly be attracted in sufficient quantity, and the search for mineral deposits will not be maintained. In other words, the potential wealth lying beneath the earth's surface will remain unrealized.

The exceptional degree of risk encountered in the mining industry is not confined to exploration activities. The development of new mines also requires enormous capital commitments to projects of a highly speculative nature. Some of the more important factors that account for the high risk involved in bringing a new mine into production are the following:

- (a) It is generally necessary to commit substantial amounts of capital on the basis of very limited information as to the extent and grade of ore available and in the knowledge that forecasts of the ultimate amount of capital costs involved in bringing the property into production and of future revenues are frequently unreliable.

- (b) Mineral deposits found in Canada and particularly in the Precambrian Shield are generally difficult to assess from the surface, commonly extending to depths beyond the reach of surface drilling and being irregular as to shape and uniformity in the way in which mineralization occurs. This problem is becoming more severe since most deposits lying at or near the surface are found first, leaving it increasingly difficult to make new discoveries. Numerous examples could be cited of very substantial expenditures on the development of properties that have proved to be unproductive. Consolidated Sudbury Basin Mines Limited, for instance spent over \$15 million in bringing a property to the point of production before it became evident that the mine could not be operated economically.
- (c) Uncertainties as to the capital cost involved in developing a new mine also arise through a wide variety of unforeseen problems that may be encountered in reaching an ore body and preparing it for mining. The difficulties encountered in developing the potash mines in Saskatchewan illustrate this type of problem. Mining operations must contend with many unpredictable forces, such as those associated with great pressures, flows of water, heat, problems of ventilation, and tendency of the ground to fragment. The effects of one or more of these forces can be drastic and greatly increase the cost of mining and even force the mine to abandon operations.
- (d) Estimates of the capital costs involved may also be very considerably underestimated as a result of unforeseen metallurgical difficulties encountered in the treatment of the ore. The ore developed in the Giant Yellowknife mine, for example, proved to be of a refractory type, requiring special roasting and flotation processes. This involved heavy additional capital expenditures that had not been anticipated, with consequent lower returns due to the higher treatment costs.
- (e) Forecasts of operating costs made prior to the development of a mine may also prove to be unreliable. Unforeseen problems arising through the geological structure of the area may entail unusually expensive mining practices, such as occurred in the Kirkland Lake area where problems of rock-burst were encountered.
- (f) Estimates of future revenues depend on forecasts of future mineral prices, and such forecasts are of necessity frequently little more than guesswork. The market prices of most metallic and industrial minerals are determined in international markets and have varied over a wide range.

It will be appreciated that, in the mining industry, it is necessary to make the majority of capital expenditures required to bring a mine into production long before any of these uncertainties can be resolved. A lead time of five years or more is not unusual before sales of the products of a new mine can be anticipated.

While it is not possible to identify in any precise way the extent to which the special tax provisions relating to the extractive industries are required to compensate for additional provincial taxes, social costs and the high risk factor, it is important to recognize that these provisions are by no means purely incentive in nature. Without them, mining would bear a much heavier burden than other industries.

The effect of the incentive provisions

In order to appreciate the significance of the White Paper proposals it is necessary to understand the effect of the present provisions on the economics of exploration and new mine development. This requires an examination of the way in which the principal incentive provisions (the three year exemption for new mines and the depletion allowance) influence the level of exploration for new mineral deposits and decisions to proceed with the development of new mines from the discoveries that have been made.

The importance of exploration activity is obvious. Mineral deposits are of no value unless they are found, extracted, processed, and sold. The development of discovered mineral deposits is important, not only for the value of the production achieved from the mineral reserves originally located, but also in locating additional ore reserves that could not have been detected by an economical program of exploration conducted from the surface. Many important discoveries have been made possible only as the result of the decision to develop what appeared to be a very limited and marginal orebody based on information obtained by drilling and other exploration from the surface.

Exploration activity depends primarily on the prospect of discovery of valuable mineral deposits, and it is in their effect on the value of new mineral discoveries that the depletion allowance and new mine exemption exert their main influence on the level of exploration work carried out in Canada. A material reduction in the value of discoveries would reduce the potential reward for successful exploration, and inevitably would be reflected in reduced exploration effort and a lower rate of mineral discovery.

In order to assess the significance of the present incentive provisions we have made studies of their effect on the value of new mineral discoveries covering a representative range of mining situations. This study, the results of which are

summarized in Schedule I of Appendix A attached, indicates that the elimination of the exemption and depletion provisions would reduce the discovery value of these mines by between 40% and 100%.

These results were confirmed by a study of the effects of the Royal Commission's proposals prepared for the Department of Finance by Professor G. David Quirin of the Institute for the Quantitative Analysis of Social and Economic Policy of the University of Toronto. This study, based on an analysis of 24 mines brought into production between 1955 and 1966 indicated that the net present value of output from those mines that produced a satisfactory return under existing provisions would be reduced by approximately 40% under the Royal Commission's proposals (i.e. without exemption or depletion).

The impact of the three-year exemption and depletion allowance provisions on the value of new mineral discoveries is obviously very considerable indeed. If the value of the prospective reward for successful exploration was cut by 40% in Canada without any comparable reduction in the reward for exploration in other parts of the world, one could expect the long-term effect on levels of exploration in Canada to be dramatic.

The studies referred to above also indicate the significance of the exemption and depletion provisions to the prospective rate of return on the estimated investment required to bring new mines into production. The effect of these provisions on the prospective rates of return of the various projects studied is summarized in Schedule II of Appendix A attached. While the percentage drop varies considerably for individual mining projects, it is clear that the exemption and depletion provisions represent a very material factor in all cases.

Some of the projects studied were marginal propositions based on the rates of return that could be forecast at the time the decisions had to be made. In each case, however, there was some possibility of better results than could be forecast with any assurance, and this was sufficient to justify the necessary investment under the existing tax provisions. Without the depletion and new mine exemption provisions, it is highly unlikely that these mines would have been developed.

All of the other projects were considered to be valuable properties, based on the existing tax provisions. In each case the projected cash flow appeared more than adequate to justify the investment required to bring the mine into production, thus establishing some value to the mineral discovery. Some of these discoveries were sufficiently valuable that they could have been developed without either of the incentive provisions, assuming that the exploration activity that led to the discovery would have been undertaken in the first place. The most

valuable of the properties covered in the study had been discovered only after extensive exploration in the particular area by the company concerned over a period of twenty years. Without the prospect of substantial reward this exploration program would probably have been discontinued long before the discovery was made.

Form of the incentives

It is important to note that the benefit of exemption and depletion provisions accrues only to successful ventures and in direct proportion to the degree of success. No special relief is provided for unsuccessful exploration and development projects, and the benefit enjoyed by marginally profitable mining ventures is relatively small. We believe this to be an extremely important aspect of the present provisions and one that should be preserved in an industry that is heavily dependent on the experience and sound judgement of those who must make decisions concerning exploration programs and development projects. Canada's excellent reputation in the field of mining and mineral exploration is founded on the development of highly skilled organizations led by men of proven good judgement. By compensating for the high risks and other special factors peculiar to the industry in the form of provisions designed to bonus the rewards for sound decisions, our present tax system has contributed to the development of an industry that enjoys world-wide recognition for competence and efficiency.

III THE OUTLOOK FOR THE CANADIAN MINING INDUSTRY

The future of the Canadian mining industry will depend on many factors. Some of these should be decidedly favourable. World consumption for most of the minerals produced in Canada is expected to increase substantially in the years ahead, increasing the potential market for our mineral production. Canada's proximity to major North American markets, its freedom from serious political unrest and threats of expropriation, and its financial stability have worked to our advantage in attracting capital for exploration and development of minerals in Canada.

There are, on the other hand, a number of significant developments that will adversely affect the competitive position of the Canadian mining industry, and its ability to attract capital for exploration and for the development of known mineral deposits.

Mineral developments in other Countries

Important mineral discoveries have recently been made in other parts of the world, and the prospects for major new mining developments in Australasia, Africa and Latin America appear excellent. The economics of transportation of bulk cargoes is rapidly changing with the development of giant ocean carriers that will reduce, and in some areas reverse, the advantage of Canadian mines in relation to the U.S. market.

Australia is a very good example. In the 1959-1968 decade, the value of mineral production increased in that country by 250%, and the exploitation of recent mineral discoveries has had a profound effect on the Australian economy. In 1969 the Australian gross national product leaped in real terms by no less than 8 percent — a rate of growth higher than any other country except Japan. Foreign investment, which is playing a vitally important role in Australia's mining developments, now exceeds \$1 billion (Australian), and in 1968 116 overseas companies were engaged there in mineral exploration and development.

Increased cost of discoveries in Canada

At the same time, the difficulty and cost of locating new ore reserves in Canada has been increasing steadily. Exploration must be carried out in more remote areas, or at greater depths, using advanced and expensive techniques.

With the increasing cost of locating new mineral deposits in Canada and improved prospects for mineral developments in other parts of the world, it must be expected that Canada will face increased competition for capital for mineral exploration and development, even without any adverse changes in the relative weight of taxation. This can only be made worse by a substantial withdrawal of tax incentives in Canada in the absence of any similar action on the part of other mineral producing countries.

Tax Incentives in other Countries

A 1969 study undertaken by this Association and covering no less than 68 countries in Africa, Asia, Australia, The Caribbean, Central America, Europe, South America and the South Pacific, indicates that in all cases special incentives were offered to mining. In some of these countries the reward offered for mineral exploration and development is greater than in Canada. Australia, for example, offers an exemption from tax of an amount equal to 20% of the income derived from mining most major minerals and an investment allowance of 20% of the cost of most processing equipment in addition to regular depreciation. The United States offers percentage depletion at varying rates based on the gross revenue from mining with a maximum deduction of 50% of the net income before depletion, compared with

Canada's present allowance of 33-1/3% of net income. These countries are not reducing the tax incentives provided to promote mining exploration and development. In the U.S. for example, after exhaustive examination and hearings on the subject, Congress substantially maintained existing levels of depletion allowances for hard minerals.

In other words, the Canadian mining industry is being faced increasingly with a highly competitive world environment. It cannot be assumed that world markets are assured for any Canadian-produced minerals. Even in commodities where this country holds a dominating position, the impact of new discoveries in other countries is making itself felt. If the ground rules are to be changed at the very time when world competition is increasing rapidly and when Canada will have to rely more and more on the development of large-tonnage low-grade ores at higher costs and often in more remote areas, it is evident that less international capital, which is already in short supply, will be attracted.

The need for increased exploration

What is needed at this period in time is maximum encouragement to explore, discover and develop new deposits, for it is acknowledged that Canada is presently drawing on reserves of potential orebodies faster than she is replacing them. A comparison of mineral discoveries in Canada since 1950 with the number of mines coming into production since 1955 or planned for early production was made by Dr. Duncan R. Derry, a noted Canadian geologist, in a paper presented at the 1967 Annual General Meeting of the Canadian Institute of Mining and Metallurgy. Dr. Derry, has since published an additional paper up-dating the statistics included in the earlier study. *

This indicates that the ratio of new discoveries to production initiations over the fourteen year period from 1955 to 1968 has been approximately 5.3 to 9. Dr. Derry states:

"This means that an average of 4 production initiations per year have depended on old showings found in the past and 'shelved' to await improved economic conditions. The question is raised again — 'Are we putting on the shelf a sufficient number of lower grade deposits for future use to balance those we are taking down from the shelf?' This is difficult to answer, because no major company 'shelving' a marginal deposit is likely to publish the fact. It is my impression, however, that we are using up our store faster than we are replenishing it. It appears that the ratio of exploration expenditures to production value must be increased if we are to provide sufficient new reserves for the future."

*C.I.M. Bulletin, March, 1970.

IV EFFECT OF THE WHITE PAPER PROPOSALS ON EXPLORATION AND DEVELOPMENT OF NEW MINES

Having reviewed the way in which the present incentive provisions affect mining exploration and new mine development and commented on the present outlook for the Canadian Mining Industry, we now turn to an assessment of the White Paper proposals and their probable impact on that industry.

The White Paper proposes to abolish the three-year exemption for new mines and to substitute a provision permitting accelerated deductions for expenditures on plant and equipment acquired for the purposes of a new mine. In addition percentage depletion would be allowed only if "earned" by incurring expenditures on exploration and development and on plant and equipment for new mines.

While the White Paper acknowledges the need for special treatment for the mineral industry, and that "exploration for and development of minerals still warrant some support" it states the belief that "support on a less generous scale should suffice for this purpose". There is, however, no indication of how it has reached this conclusion. In its discussion of the economic implications of the proposals, the White Paper observes that the proposed changes affecting the mineral industry would have "some effect" in reducing the expected rate of return from new mining projects. After noting that "the overall effect on the development of new mines cannot be forecast with any certainty; it would probably depend on general attitudes as well as on calculations," it proceeds to express unexplained confidence that the effect would not be serious "although no doubt there would be some marginal projects abandoned or deferred in the next several years" and concludes by stating: "All in all, the mineral industries would continue to be stimulated by some tax measures not offered to other industries, but not to as great a degree as under the present law."

Such statements might be more reassuring if there was some indication that the expressed complacency was based on a careful appraisal of the effect of the proposals on the economics of exploration and new mine development. Our own assessment leads us to believe that the White Paper proposals would have a profound and immediate effect on levels of exploration and consequently on the development of new mines in Canada. We believe that the significance of the changes proposed has been badly underestimated and, in view of the importance of the mining industry to the Canadian economy, and the contribution it has made, and could continue to make, to economic growth and regional development, we are deeply concerned about the danger of a serious error in judgement on this vital point.

Effect on exploration

In assessing the significance of the White Paper proposals on future levels of exploration in Canada, we have attempted to measure their approximate effect on the value of new mineral discoveries. This value represents the reward for successful exploration. Any material reduction in the reward would inevitably result in reduced exploration, although the relationship is not likely to be a direct one. Rather, it seems likely that any major change in prospective discovery values would have a disproportionate effect on exploration activity, and hence on the rate of new mineral discovery in Canada.

The studies we have made indicate that the White Paper proposals would reduce the discovery value of new mineral deposits dramatically. The extent of the reduction varies widely, depending on the nature and size of the orebody. In the case of some mines that would be only slightly better than marginal propositions under the existing tax provisions, the White Paper proposals would make it uneconomic to bring the mine into production, and this would virtually eliminate the value of the discovery. In the case of the more valuable properties, the reduction would appear to be in the range of 33-1/3% to 75%. The effect of the proposals on discovery value of the mines covered in our study is set out in Schedule I of Appendix A attached.

It seems clear that the White Paper proposals would have a dramatic effect on the potential reward for successful exploration. The effect of this on the level of exploration activity in Canada would be further compounded by the withdrawal of the exemption presently available to prospectors and their backers in respect of gains realized on the disposal of mineral properties.

Effect on development

The effect of the White Paper proposals on the economics of new mine development can be seen from their effect on prospective rates of return on the estimated investment required to bring a new mine into production. This is illustrated by the studies we have made, the results of which are summarized in Schedule II of Appendix A attached. While the reduction in the prospective rates of return varies considerably, it is clear that many of the projects would be rendered uneconomic.

The study summarized in Schedule II also illustrates the extent to which the relief provided by the present exemption and depletion provisions would be preserved under the White Paper proposals. Based on their effect on rates of return, the relief provided by the White Paper proposals would be reduced in all cases to less than half the relief provided by the present proposals, and generally to approximately one-third. Since the present provisions are required in part to compensate for additional provincial taxes and royalties on mining income and

for the high risk nature of the industry, it seems likely that the overall effect of the proposals would be to virtually eliminate the incentive element of the present provisions.

Effect on existing mining operations

The White Paper proposals would have the effect of increasing the tax burden on existing mining operations, after the transitional five-year period, by the elimination of percentage depletion unless "earned" by expenditures on exploration or new mine development. For sections of the industry where substantial exploration programs are not required, the effective rate of tax on profits would become substantially higher than that imposed on most other industries when provincial mining taxes are taken into account.

Combined federal and provincial income and mining taxes would increase by one-third to about 60%. Apart altogether from the question of equity to those who have made substantial investments in response to the existing tax provisions, tax rates as high as this would seriously discourage new investment in extending ore reserves or expanding production and processing capacity. The companies concerned would find it more difficult to finance such expenditures out of income generated internally due to higher taxes on existing operations. And they would have less incentive to do so due to the reduction in rates of return.

As a result, investment required to expand production or prolong the life of existing mines would be made substantially less attractive and more difficult to finance.

Possible Modifications to the Present Provisions

We fully appreciate that the present incentive provisions are not perfect in every respect and that some improvements could be made. In our view, however, the overriding principle must be to maintain truly effective incentives to exploration and mining comparable to those presently in force. In other words, the objective must be to improve the effectiveness of the incentive provisions without increasing their cost or to reduce their cost without material loss of effectiveness.

We believe that the three-year tax exemption for new mines has proved to be an extremely powerful and effective incentive and that it should be retained. However, it might be possible to reduce the cost of this incentive without too great a loss of effectiveness by limiting the aggregate amount eligible for exemption during the three-year period to the capital invested to develop the mine. This would include pre-production development expenses and the cost of assets acquired for the purpose of earning income from the new mine; e.g.,

mine buildings and equipment and related facilities such as townsites, roads, terminal and dock installations, etc. Exempt income would, as at present, be determined before deduction of capital cost allowance and exploration and development expenses.

In connection with the depletion allowance, one weakness of the present system is that exploration and development expenses must be deducted before computing the allowance. This has the effect of reducing the value of depletion as an incentive to explore and develop. To overcome this, the allowance could be calculated by reference to profits determined before rather than after deduction of exploration and development expenditures.

If, on the other hand, the White Paper concept of an "earned" depletion allowance is adopted as the basic form of incentive for exploration, it will be necessary to provide compensation for the additional burden on the mining industry resulting from provincial mining taxes and social costs normally borne by the public sector. This could take the form of a continuing percentage depletion allowance, at a rate lower than the present 33-1/3% rate. Thus all mines would qualify for a basic percentage allowance to bring their effective tax burden down to a level comparable to other industries, and would be eligible for incentive allowance along the lines proposed in the White Paper. If this approach were to be adopted, further consideration ought to be given to expanding the types of expenditures qualifying for the earned allowance. They should, for example, include major investments required to expand existing facilities or to up-grade ores that might otherwise be sub-marginal.

V COMMENTS ON OTHER WHITE PAPER PROPOSALS AFFECTING THE MINING INDUSTRY

Corporations and shareholders

The White Paper proposes fundamental changes in the taxation of dividends from Canadian companies in the hands of Canadian shareholders. In place of the present relatively simple system of inter-company dividend exemptions and 20 % dividend tax credits, an extremely complex system would be introduced under which dividends would be taxable in the hands of corporate as well as individual shareholders subject to credit in respect of Canadian taxes paid by the distributing company on the income from which the dividend was paid. The proposed system would clearly give rise to many very serious difficulties, quite apart from the administrative and compliance problems involved, and it is by no means clear that solutions to these difficulties have been, or can be, worked out. Furthermore, no convincing case has been made out for the need for such an awkward and cumbersome treatment of corporate distributions.

The mining industry is particularly concerned about the proposed treatment of inter-company dividend distributions, under which all dividends paid out of profits that have not borne Canadian tax would be subject to full corporate tax in the hands of Canadian corporate shareholders, unless the paying company qualifies for election to be treated as a partnership. This treatment would be highly inappropriate and would cause serious and quite unjustified rigidity in the corporate affairs.

There are many circumstances in which companies develop earnings and surplus cash available for dividends beyond the amount on which full Canadian tax would be payable. These would include income subject to depletion allowances, exempt income from new mines, capital cost allowances in respect of depreciable property in excess of debt amortization and depreciation recognized in the accounts, losses carried forward from prior periods, and income from foreign subsidiary companies. In all such cases, income available for distribution could not be paid out to corporate shareholders without giving rise to liability for corporate tax in the hands of such shareholders. This would inevitably result in uneconomic retention of effectively locked-in surplus funds in the hands of companies whose shares are held mainly by other Canadian corporations, and would inhibit their profitable employment. In view of the prevalence of inter-company shareholding investments in the mining industry (a situation that develops naturally from the nature of the industry and the manner in which new mining ventures are discovered and financed) this problem would be particularly severe for companies engaged in this industry. It is difficult to conceive of any valid reason for the treatment proposed or of any serious objection to the continuation of the present exemption for inter-company dividends.

A further serious objection to the proposed system of gross-up and credit for Canadian corporation tax is that it would nullify the effect of any incentives made available to corporations at the time profits benefiting from the incentives were distributed to Canadian shareholders. Thus the benefit of new mine exemptions, depletion allowances or rapid amortization of mine plant and equipment would be effectively withdrawn in the case of distributions to taxable Canadian shareholders, and would only accrue fully to non-resident shareholders. This is surely undesirable from the point of view of Canadian ownership of resource companies as well as in its impact on the effectiveness of the incentives.

Other objections to the integration proposals include the 2½ year time limit on distributions in order to qualify for relief in respect of creditable tax, problems created in dealing fairly with shareholders holding different classes of shares, and the unnatural distinctions made between closely-held and widely-held companies. The 2½ Year time limit on distributions would result in a serious and unjustified penalty in the many situations in which cash or stock distributions cannot be

made within 2½ years of the payment of tax liabilities. This may arise, for example, in cases where companies do not have sufficient surplus to permit the legal payment of dividends, or where restrictions on dividend payments have been provided in debenture trust deeds and other contractual arrangements. Problems arising from the distribution of creditable tax between shareholders holding different classes of stock do not appear to have been seriously considered, and would frequently put directors of companies in the untenable position of being forced to favour one class or another depending on the timing of dividend and tax payments.

The distinction between closely-held and widely-held companies is obviously arbitrary and unnatural and would result in innumerable anomalies and inconsistencies. The treatment of dividends from a widely-held company received by a closely-held company most of whose shares are held by a widely-held company, to give only one not uncommon example, is clearly inappropriate.

The Association strongly urges the deferral of further consideration of the proposals for integration of corporation and personal tax at least until the more important issues of the tax reform have been dealt with. In the meantime, the present 20% dividend tax credit for Canadian shareholders and exemption for inter-company dividends should be retained.

International income

The White Paper proposes major changes in the taxation of foreign source income of Canadian companies, apparently designed primarily to prevent avoidance of tax through the use of tax haven jurisdictions. The Association seriously questions the need for highly complex provisions of general application to deal with a problem of relatively limited scope. Surely real abuses can be dealt with effectively without fundamental changes affecting the legitimate foreign operations of the vast majority of Canadian businesses.

The proposal to limit the present exemption in respect of dividends received from controlled foreign subsidiaries to foreign countries with which Canada has negotiated a tax treaty would be likely to cause serious difficulty. The Canadian mining industry is presently involved in mining and exploration activities in a great many foreign countries, a number of which would be classed as under-developed. The Association believes that it will prove much more difficult to negotiate tax treaties with many of these countries than the government seems to anticipate. There would seem to be little justification for penalizing Canadian companies with foreign operations on account of difficulties encountered in the negotiation of treaties that are entirely beyond their control.

Capital gains

The absence of tax on capital gains has been an important factor

in the past in Canada's success in attracting capital from investors willing to accept the higher risks necessarily associated with discovery and development of new opportunities and new sources of wealth. This has been of particular importance to the successful development of the Canadian mining industry. The nature of exploration and new mine development is such as to require substantial capital commitments to ventures involving a high degree of risk. Without the prospect of exceptional rewards for the few successful ventures it would not have been possible to attract the capital needed to finance the exploration and development effort that has contributed so greatly to the Canadian economy.

It is not therefore surprising that the mining industry should regard the introduction of a tax on capital gains as undesirable. While the right to deduct losses on unsuccessful investments would no doubt compensate to some extent for the disincentive effect of a tax on gains, it seems likely that the net effect would be to discourage new investment in mining and exploration. The industry depends on its ability to appeal to investors who adopt a more optimistic approach than might appear to be warranted on the basis of statistical evidence. Such investors are more likely to be influenced by the treatment accorded the gains they hope for than by the prospect of relief for losses they prefer not to contemplate.

While the industry believes that any general tax on capital gains would be detrimental to the future development of Canada's mineral resources, it is particularly concerned about the White Paper proposal to treat gains, other than those realized on shares of widely-held companies, as ordinary income subject to full tax rates, and the failure to compensate for the proposed taxation of capital gains by withdrawal from the estate tax field. The resulting tax burden imposed on capital values would be far more severe than that applied in the United States, where the taxation of capital gains is, at worst, limited to half rates, and in the case of substantial gains, commonly escapes capital gains tax altogether as a result of the tax-free adjustment of values permitted on death.

In the event that taxation of capital gains were to be introduced, it is most strongly urged that Canada should not require the inclusion in income of more than one-half of capital gains. In addition, the introduction of taxation of capital gains should be accompanied by the elimination of estate tax and succession duties.

The industry also strongly opposes the proposed five-year revaluation of shares of widely-held companies. Such a requirement could have devastating effects in the case of shares of mining companies that may vary widely in price within very short periods.

APPENDIX A

STUDIES OF THE EFFECT OF THE PRESENT EXEMPTION AND DEPLETION PROVISIONS AND THE WHITE PAPER PROPOSALS ON NEW MINE PROJECTS

Studies have been made to illustrate the effect of the present exemption and depletion provisions, and of the White Paper proposals, on the value of new mineral discoveries and on the indicated rates of return on the investment required to bring new mines into production. Results are summarized in the attached Schedules I and II.

Two groups of mines have been used: a group of 10 actual mining projects forming the basis of an earlier study prepared for the Royal Commission on Taxation, and a group of nine hypothetical mining ventures with varying life span and profitability. Our objective in this was to illustrate the effects of the present provisions and the White Paper proposals on as wide a range of mining ventures as possible.

Group A

The mines in this group were included in a study prepared for a submission by this Association to the Royal Commission on Taxation in March 1965. These are all actual mining projects that had been brought into production within the previous 10 years, or were in the process of development at the time the studies were made. The mines selected were all those for which data could be obtained readily, and the information used was based, wherever possible, on the original forecasts at the time the decisions were made to bring the mines into production. In the case of certain mines already in production, where original forecasts were no longer available actual results to the time of the study were used, together with forecasts for the future, adjusted so far as possible to eliminate the effect of developments that could not have been foreseen.

The following is a brief description of the mines included in this group:

Mines A1 to A3

These mines were considered to be marginal at the time decisions were made to proceed with development.

Mine A1 had ore reserves indicated by surface drilling sufficient to maintain production for approximately four years. In the absence of additional reserves this would have been barely enough to recover the investment required to bring the mine into production. This mine was,

however, brought into production primarily because the chances of finding additional ore zones were considered to be favourable, although this could not be confirmed from the surface.

Under the existing tax provisions, the indicated rate of return would have been 15.0% if production could be maintained for 10 years at the level contemplated, and this was considered sufficient to justify the necessary investment. Without the exemption and depletion provisions, the projected rate of return would have been only 10.1% on the favourable assumption of a 10-year life, and under the White Paper proposals this assumption would result in a projected rate of return of 11.9%. In view of the uncertainties involved, particularly as to the extent of the ore reserves, it seems unlikely that this mine would have been developed without the exemption and depletion provisions, or under the White Paper proposals.

The calculated discovery value of this mine, based on an assumed life of 10 years, would be reduced by 76.1% without exemption or depletion, and by 50.7% under the White Paper proposals.

Mine A2 was under consideration at the time of the study. Sufficient ore reserves had been established to maintain production for over twenty years at the level contemplated, but the projected rate of return of 9.8% was considered to be barely adequate in view of the substantial investment involved, concern as to the reliability of estimates of the development costs and the length of the period involved in the estimates. Even the relatively minor drop (from 9.8% to 8.9%) in the projected rate of return under the White Paper proposals would probably have rendered this mine uneconomic. Without the exemption and depletion provisions, the mine would have had no discovery value, and the White Paper proposals would have cut the discovery value by 53.8%.

Mine A3 was considered marginal on the basis of an indicated rate of return of 12.7% under the present tax provisions. Market prices for the mineral involved had been very unstable and had varied over an extremely wide range. In the circumstances, forecasts of cash flow based on current market prices were clearly speculative, and the decision to bring the mine into production would probably not have been favourable on the basis of the White Paper proposals with an indicated rate of return of 10.7%. Here again, the White Paper proposals would have reduced the discovery value of the mine by more than one half. After this mine was brought into production, market prices dropped to about half the price used in the forecasts, and the mine

was temporarily shut down. Prices subsequently recovered, and the mine was once again put into production.

Mines B1 to B6

These mines were all considered to be somewhat better than marginal, and the projected cash flow based on existing tax provisions was sufficient to justify the investment required to bring them into production. In each case, the exemption and depletion provisions made a material difference to the rate of return, and without them most of these properties would probably have been left undeveloped. The White Paper proposals would have reduced rates of return by between 60% to 75% of the reduction caused by the elimination of the exemption and depletion provisions, and would have reduced the discovery values of these properties by between 40% and 100% of their values under the present provisions.

Mine C1

This mine involved a discovery that was so valuable it would clearly have been brought into production without either the exemption or the depletion provisions. However, it seems unlikely that this mine would have been discovered at all in the absence of effective incentives. This discovery was made only after extensive exploration in the particular area by the company concerned over a period of 20 years. Without the prospect that the value of discovery could be substantial, this exploration program would probably have been discontinued long before the discovery was made. The discovery value of this property would have been reduced by about 44% under the White Paper proposals.

Group B

The mines in this group are hypothetical mining projects with varying levels of profitability and with life spans of five years, 15 years and 25 years. The operating profit selected for the first mine in each category was designed to result in a rate of return slightly better than 12% under the present tax system. These are representative of mining projects that are presently little better than marginal propositions. The second mine in each life span represents a profitable mine, with an operating profit sufficient to produce a rate of return of approximately 20% under the present provisions. The last mine in each category has an operating profit that would result in a rate of return in excess of 25% on the investment in the mine. These are intended to represent very valuable discoveries.

In each case, the cost of bringing the mine into production has been taken as \$10 Million, broken down as follows:

Reproduction expenses	\$ 1,000,000
Depreciable assets	8,500,000
Working Capital	500,000
	\$10,000,000

The effect of the exemption and depletion provisions on the discovery values of these mines is dramatic. Without them, the value of the most profitable mine in the long-life category would be reduced by more than 40%. The values of the medium profitability mine in this category would be almost cut in half, as would the two profitable mines in the 15 year life category. All of the marginal mines would lose all discovery value, and the values of profitable mines in the short-life category would be cut by 70-85%.

The White Paper proposals would also materially reduce the discovery values of all of these mines, generally by between 33-1/3% and 75%. The relief provided by the exemption and depletion provisions in terms of increased rates of return would be cut to between one-half and one-third by the White Paper proposals.

Schedule I indicates the effect on the discovery values of the various mining properties. The discovery value of each mine has been estimated by deducting the cost of bringing the mine into production from the present value of the projected cash flow from the project, discounted by a 10% interest factor. While this does not, of course, represent a precise measure, it does provide a reasonable indication of the value of the undeveloped properties, and thus of the potential reward to the explorer who made the discovery.

Columns 4 and 5 of this schedule indicate the amount by which the calculated discovery values would be reduced by elimination of the exemption and depletion provisions, and by the White Paper proposals.

Schedule II summarizes the projected rates of return on the investment in each of the mines under the present tax provisions (column 1), without exemption on depletion (column 2), and under the White Paper proposals (column 3).

Column 4 indicates the portion of the rate of return based on present provisions that is represented by the relief provided by the exemption and depletion provisions. Column 5 shows the portion attributable to the more limited relief provided under the White Paper proposals. Column 6 shows the relief provided under the White Paper proposals (column 5) as a percentage of the relief provided by the existing provisions (column 4). This provides a measure of the extent to which the relief provided by the present provisions would be preserved under the White Paper proposals.

STUDIES OF EFFECT OF EXEMPTION AND DEPLETION PROVISIONS AND THE WHITE PAPER PROPOSALS
ON THE VALUE OF NEW MINERAL DISCOVERIES

			Discovery value			Decrease in discovery value as % of value under present provisions	
	Investment required to bring mine into production (000's)	Estimated life of mine	Present tax provisions (000's) (1)	Without exemption or depletion (000's) (2)	White Paper proposals (000's) (3)	Without exemption or depletion (4)	White Paper proposals (5)
Group A—actual mines							
A1—a	2,000	4 years	\$ nil	\$ nil	\$ nil	—	—
A1—b	2,000	10	710	170	350	76.1 %	50.7 %
A2	43,400	50	7,150	nil	3,300	100.0	53.8
A3	4,300	12	980	120	460	87.8	53.1
B1	48,000	29	14,340	3,560	6,740	75.2	53.0
B2	15,400	13	3,490	60	1,280	98.3	63.3
B3	3,460	5	1,170	280	570	76.1	51.3
B4	36,000	20	7,600	nil	2,430	100.0	68.0
B5—a	28,000	10	240	nil	nil	100.0	100.0
B5—b	28,000	20	5,750	nil	1,870	100.0	67.5
B6	21,200	30	18,870	9,400	11,040	50.2	41.5
Σ:	7,035	6	18,400	9,070	10,220	50.7	44.5
Group B—hypothetical mines							
1A	10,000	5	1,390	nil	nil	100.0	100.0
1B	10,000	5	4,230	610	1,690	85.6	60.0
1C	10,000	5	7,050	2,110	3,280	70.1	53.5
2A	10,000	15	1,560	nil	370	100.0	76.3
2B	10,000	15	6,320	2,760	3,770	56.3	40.3
2C	10,000	15	11,010	5,800	6,980	47.3	36.6
3A	10,000	25	1,980	nil	700	100.0	64.6
3B	10,000	25	8,640	4,510	5,520	47.8	36.1
3C	10,000	25	14,120	8,130	9,320	42.4	34.0

STUDIES ON EFFECT OF EXEMPTION AND DEPLETION PROVISIONS AND THE WHITE PAPER PROPOSALS
ON PROJECTED RATE OF RETURN

	Investment in mine (000's)	Estimated life of mine	Projected rate of return			Extent of relief in terms of return provided by		Relief provided by White Paper proposals as % of present provisions (6)	
			Present provisions (1)	Without exemption or depletion (2)	White Paper proposals (3)	Depletion and exemption (4)	White Paper proposals (5)		
Group A actual mines									
A1—a	2,160	4 years	1.7%	—	—	1.7%	—	—	
A1—b	2,160		10	15.0	10.1%	11.9%	4.9	1.8%	36.7%
A2	51,400		50	9.8	8.1	8.9	1.7	.8	47.1
A3	4,594		12	12.7	9.2	10.7	3.5	1.5	42.9
B1	48,000	29	13.8	11.1	12.0	2.7	.9	33.3	
B2	16,330	13	12.7	8.9	10.4	3.8	1.5	39.5	
B3	4,310	5	12.2	5.6	7.9	6.6	2.3	34.8	
B4	36,000	20	13.0	9.9	11.1	3.1	1.2	38.7	
B5—a	28,526	10	9.8	5.6	7.4	4.2	1.8	42.9	
B5—b	28,526	20	12.9	9.6	10.8	3.3	1.2	36.4	
B6	22,200	30	20.3	15.2	16.5	5.1	1.3	25.5	
C1	8,285	6	57.2	35.9	41.0	21.3	5.1	23.9	
Group B hypothetical mines									
1A	10,000	5	13.9	7.2	9.5	6.7	2.3	34.3	
1B	10,000	5	21.1	11.8	15.1	9.3	3.3	35.5	
1C	10,000	5	27.5	16.0	19.7	11.5	3.7	32.2	
2A	10,000	15	12.5	9.3	10.7	3.2	1.4	43.8	
2B	10,000	15	19.5	14.6	16.4	4.9	1.8	36.7	
2C	10,000	15	25.5	19.0	21.3	6.5	2.3	35.4	
3A	10,000	25	12.6	10.0	11.0	2.6	1.0	38.5	
3B	10,000	25	20.3	15.9	17.5	4.4	1.6	36.4	
3C	10,000	25	26.0	20.0	22.0	6.0	2.0	33.3	

TABLE 1. Value of Mineral Production of Canada, by Classes, 1946-1969

Year	Metals	Non-Metals	Fossil Fuels	Structural materials	Total
	Dollars				
1946	290,386,425	43,792,717	102,516,888	66,120,221	502,816,251
1951	745,877,561	115,418,150	232,854,093	151,333,791	1,245,483,595
1961	1,387,159,036	210,467,876	653,327,802	331,345,763	2,582,300,387
1962	1,496,433,950	217,453,009	780,932,387	356,166,833	2,850,986,179
1963	1,509,536,931	253,452,413	908,428,087	379,011,116	3,050,428,547
1964	1,701,648,538	284,497,000	998,767,672	403,058,324	3,387,971,534
1965	1,907,575,899	327,238,901	1,076,494,117	434,161,904	3,745,470,821
1966	1,984,672,572	363,387,717	1,150,611,731	474,108,899	3,972,780,919
1967	2,285,547,427	406,269,252	1,258,924,742	448,197,382	4,398,938,803
1968	2,492,599,647	446,922,191	1,342,549,863	443,269,446	4,725,341,147
1969 p	2,320,947,545	444,188,679	1,461,399,937	461,206,039	4,687,742,200

Source: Dominion Bureau of Statistics

p Preliminary

Table 2. Mineral Production of Canada, by Provinces, 1950-1960-1969

Province	1950		1960		1969 p	
	Dollars	Per Cent	Dollars	Per Cent	Dollars	Per Cent
Newfoundland	25,824,047	2.5	86,637,000	3.5	239,093,692	5.1
Prince Edward Island	—	—	—	—	1,050,000	—
Nova Scotia	59,482,173	5.6	65,453,000	2.6	54,175,233	1.2
New Brunswick	12,756,975	1.2	17,073,000	0.7	98,393,595	2.1
Quebec	220,176,517	21.1	446,203,000	17.9	720,067,082	15.4
Ontario	366,801,525	35.1	983,104,000	39.4	1,214,456,935	25.9
Manitoba	32,691,173	3.1	58,703,000	2.4	245,595,701	5.2
Saskatchewan	35,983,923	3.4	212,093,000	8.5	344,752,483	7.4
Alberta	135,758,940	13.0	395,344,000	15.9	1,193,279,802	25.4
British Columbia	138,888,205	13.3	186,262,000	7.5	422,765,745	9.0
Yukon	9,035,696	0.9	13,330,000	0.5	37,655,800	0.8
N. W. Territories	8,050,899	0.8	27,135,000	1.1	116,456,132	2.5
Totals	1,045,450,073	100.0	2,492,510,000	100.0	4,687,742,200	100.0

Source: Dominion Bureau of Statistics

p Preliminary

Table 3. Mineral Production of Canada, by Kinds, 1960 and 1969

		1960		1969 p	
	Unit of Measure	Quantity	Value dollars	Quantity	Value dollars
Metallics					
Antimony.....	lb.	1,652	539	845,000	507,000
Bismuth.....	"	424	762	720,698	3,260,199
Cadmium.....	"	2,357	3,348	4,368,405	15,010,186
Calcium.....	"	135	159	888,361	925,831
Cobalt.....	"	3,569	6,763	3,203,947	6,921,780
Columbium (Cb ₂ O ₅).....	"			3,010,356	2,925,698
Copper.....	s.t.	439	264,847	558,228	574,193,275
Gold.....	troy oz.	4,629	157,152	2,502,169	94,331,773
Indium.....	oz.	...	...	...	...
Iron ore.....	ton	21,551	175,083	40,000,640	431,930,310
Iron (remelt).....	s.t.	...	10,973	...	23,475,000
Lead.....	s.t.	206	43,927	315,032	95,391,671
Magnesium.....	lb.	14,577	4,314	20,969,620	7,093,714
Mercury.....	"	...	...	...	...
Molybdenum (Mo content).....	"	768	1,015	30,291,644	52,623,117
Nickel.....	s.t.	215	295,640	213,325	482,412,858
Platinum metals.....	troy oz.	*	*	...	...
Platinum.....	"	484	28,874	...	...
Platinum group.....	"	...	...	266,100	26,449,000
Selenium.....	lb.	522	3,651	710,618	4,375,563
Silver.....	troy oz.	34,017	30,244	43,092,976	83,169,443
Tellurium.....	lb.	45	156	103,777	671,588
Thorium (ThO ₂).....	"	...	...	29,014	55,127
Tin.....	"	622	522	268,000	493,120
Titanium ore.....	s.t.	3	16	—	—
Tungsten (WO ₃).....	lb.	—	—	...	...
Uranium (U ₃ O ₈).....	"	25,495	269,938	7,709,547	49,665,506
Yttrium (Y ₂ O ₃).....	"	...	...	86,127	675,549
Zinc.....	s.t.	407	108,635	1,196,291	364,390,237
Total, metallics.....			1,406,558	...	2,320,947,545
Non-metallics					
Arsenious oxide.....	lb.	1,724	70	700,000	50,000
Asbestos.....	s.t.	1,118	121,400	1,596,450	196,759,000
Barite.....	s.t.	154	1,462	141,392	1,419,568

See footnotes at end of table

(Cont'd.)

*Platinum metals included with platinum

Table 3. Mineral Production of Canada, by Kinds, 1960 and 1969—Concluded

		1960		1969 p	
	Unit of Measure	Quantity	Value dollars	Quantity	Value dollars
Non-Metallics—Concluded					
Diatomite.....	s.t.	44	1	487	11,340
Feldspar.....	"	14	239	11,743	309,123
Feldspar.....	"	...	1,922	..	3,036,470
Garnet.....	"	32	5	..	..
Gem stones.....	lb.	..	..	45,000	107,500
Grindstone.....	s.t.	10	2	—	—
Gypsum.....	"	5,206	9,499	6,871,971	13,433,102
Iron.....	Mcf.	..	..	..	..
Iron oxides.....	ton	1	77	—	—
Lithia.....	lb.	205	84	—	—
Magnesite, dolomite, and brucite.....	ton	...	3,279	..	3,000,000
Mica.....	"	1,703	94	—	—
Mineral water.....	gal.	375	202	..	..
Nepheline syenite.....	s.t.	241	2,891	502,893	5,881,818
Nitrogen.....	Mcf.	..	..	..	..
Peat moss.....	ton	186	6,088	314,100	8,717,000
Potash (K ₂ O).....	"	...	179	3,146,160	67,119,877
Pyrite, pyrrhotite.....	"	1,032	3,316	323,432	2,111,198
Quartz and silica sand.....	"	2 261	3,267	2,263,594	5,853,623
Salt.....	"	3,315	19,356	4,247,170	29,424,420
Silica brick.....	bricks	—	—	..	..
Soapstone, talc and pyrophyllite.....	s.t.	42	523	81,427	1,191,213
Sodium sulphate.....	"	214	3,449	338,484	5,488,717
Sulphur, in smelter gas.....	"	290	2,855	550,804	8,221,795
Sulphur, elemental.....	"	274	4,299	2,984,937	62,986,315
Titanium-dioxide, slag, etc.....	"	...	12,947	..	29,066,600
Total, non-metallics.....	...	...	197,506	...	444,188,679
Mineral fuels					
Coal.....	s.t.	11,011	74,676	10,635,098	52,038,954
Natural gas.....	Mcf.	522,972	52,197	1,985,280,751	263,564,593
Natural gas by-products.....	bbl.	...	16,052	..	135,566,258
Petroleum, crude.....	bbl.	189,534	422,927	407,498,677	1,010,230,132
Total fuels.....	...	...	565,852	..	1,461,399,937
Structural materials					
Clay products.....	\$	..	38,226	...	50,995,351
Cement.....	s.t.	5,787	93,261	8,543,622	171,257,887
Lime.....	"	1,530	19,302	1,718,155	20,108,301
Sand and gravel.....	"	192,074	111,164	204,060,000	130,650,000
Stone.....	"	45,359	60,641	70,069,100	88,194,500
Total structural materials.....	...	...	322,594	...	461,206,039
Grand total.....	...	...	2,492,510	...	4,687,742,200

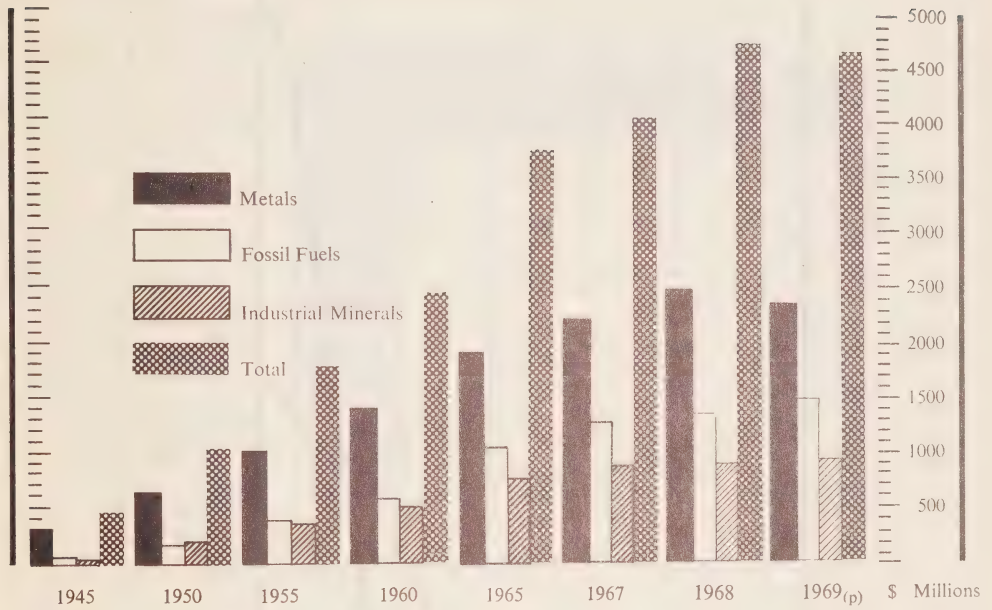
(1) Includes pyrophyllite.

.. Figures not available

.. Figures not appropriate or not applicable

— Nil or zero

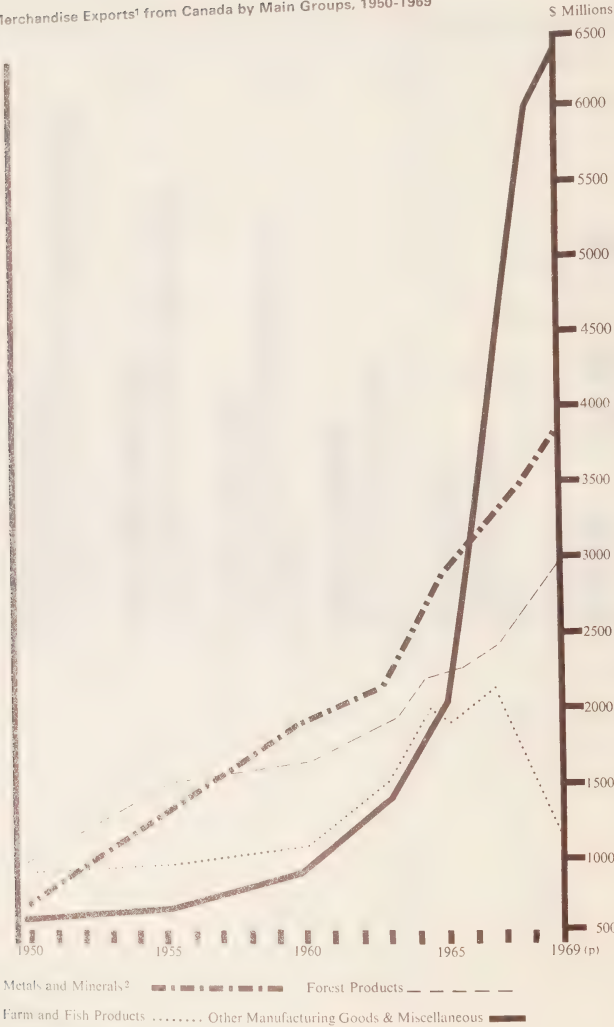
Mineral Production of Canada, by Classes 1945-1969



Source: Dominion Bureau of Statistics Data (p) Preliminary

APPENDIX B2

Merchandise Exports¹ from Canada by Main Groups, 1950-1969



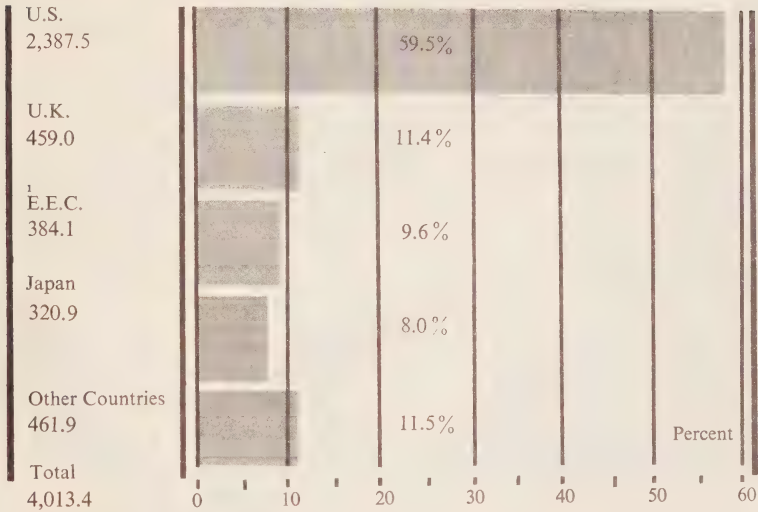
¹-Excludes exports of foreign products (re-exports) amounting to generally between 2% and 3% of total exports.

²-Excludes (a) potash, sodium sulphate, peat moss
(b) gold, with new production available for export.

Source: Bank of Canada Statistical Summary
re: 1969

Canada's Mineral Export Markets-1969 (p)

Millions of Dollars

¹ EEC = European Economic Community (p) preliminary. Source: Dominion Bureau of Statistics Data



The Principal Mining Areas of Canada

- Main Geological Regions**
- Canadian Shield
 - Plains, Lowlands, Plateaux
 - Cordilleran Region
 - Innuitian Region
 - Appalachian Region

- Producing Areas**
- Metallics** ■
- 1 nickel-copper
 - 2 copper, copper-zinc
 - 3 iron ore
 - 4 iron ore—titanium
 - 5 lead-zinc-silver (copper)
 - 6 silver
 - 7 gold
 - 8 uranium
 - 9 molybdenum
 - 10 tungsten
 - 11 niobium (columbium)
 - 12 tantalum

- Non-Metallics** ▲
- 1 asbestos
 - 2 potash
 - 3 gypsum
 - 4 fluorspar
 - 5 salt
 - 6 coal
 - 7 nepheline syenite
 - 8 sodium sulphate
 - 9 barite

LIST OF MEMBER COMPANIES

APPENDIX D

Algoma Steel Corporation, Limited, The/Algoma Ore Division	Dresser Minerals	Madeleine Mines Ltd.
Allan Potash Mines	Duval Corporation of Canada	Madsen Red Lake Gold Mines, Limited
Alwinal Potash of Canada Limited	East Malartic Mines Limited	Manitou-Barvue Mines Limited
American Smelting and Refining Company /Buchans Unit	Eldorado Nuclear Limited	Mattagami Lake Mines Limited
Anaconda Britannia Mines Ltd.	Endako Mines Ltd.	McIntyre Porcupine Mines Limited
Anglo American Corporation of Canada Limited	Falconbridge Nickel Mines Limited	New Hosco Mines Limited
Asbestos Corporation Limited	Freeport Canadian Exploration Company	New Imperial Mines Ltd.
Aunor Gold Mines Limited	Gaspé Copper Mines, Limited	Newmont Mining Corporation of Canada Limited
Bell Asbestos Mines Ltd.	Giant Yellowknife Mines Limited	Noranda Mines Limited
Bethlehem Copper Corporation Ltd.	Granby Mining Company Limited, The	Opemiska Copper Mines (Quebec) Limited
Bralorne Can-Fer Resources Limited	Granduc Operating Company	Orchan Mines Limited
British Newfoundland Exploration Limited	Granisle Copper Limited	Pamour Porcupine Mines Limited
Brunswick Mining and Smelting Corporation Limited	Gunnar Mining Limited	Patino Mining Corporation, The
Caland Ore Company, Limited	Hallnor Mines, Limited	Pine Point Mines Limited
Camflo Mines Limited	Health Steele Mines Limited	Placer Development Limited
Campbell Chibougamau Mines Ltd.	Hilton Mines, Ltd.	Potash Company of America
Campbell Red Lake Mines Limited	Hollinger Mines Limited	Quebec Cartier Mining Company
Canada Tungsten Mining Corporation Limited	Hudson Bay Mining and Smelting Co., Limited	Quebec Iron and Titanium Corporation
Canadian Exploration Limited	Indusmin Limited	Rayrock Mines Limited
Canadian Johns-Manville Co., Limited	International Mogul Mines Limited	Rio Algom Mines Limited
Carey-Canadian Mines, Limited	International Nickel Company of Canada, Limited, The	Rycon Mines Limited
Cassiar Asbestos Corporation Limited	Iron Ore Company of Canada	Selco Mining and Development Limited
Coast Copper Company, Limited	Joutel Copper Mines Limited	Sherman Mine
Cominco Ltd.	Kam-Kotia Mines Limited	Sherritt Gordon Mines Limited
Consolidated Canadian Faraday Limited	Keneco Explorations, (Canada) Limited	Sigma Mines (Quebec) Limited
Conwest Exploration Company Limited	Kerr Addison Mines Limited	Silverfields Mining Corporation Limited
Copperfields Mining Corporation Limited	Labrador Mining and Exploration Company Limited	Siscoe Mines Limited
Craigmont Mines Limited	Lake Asbestos of Quebec, Limited	Spooner Mines and Oils Limited
Denison Mines Limited	Lake Dufault Mines Limited	Steep Rock Iron Mines Limited
Dickenson Mines Limited	Lake Shore Mines, Limited	Sullivan Mining Group Ltd.
Discovery Mines Limited	Lamaque Mining Company Limited	Sunro Mines Limited
Dome Mines Limited	Leitch Mines Limited	Texas Gulf Sulphur Company
Dominion Magnesium Limited	Little Long Lac Gold Mines Limited, The	United Keno Hill Mines Limited
	Macassa Gold Mines Limited	Upper Canada Mines Limited
		Western Mines Limited
		Willroy Mines Limited

APPENDIX "D"

THE CANADIAN LIFE INSURANCE ASSOCIATION

SUBMISSION

on the

PROPOSALS FOR TAX REFORM

in the

WHITE PAPER

of the

GOVERNMENT OF CANADA

JUNE, 1970

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To the Standing Committee of the Senate
on Banking, Trade and Commerce

Re: Tax Reform

Introduction

1. The opportunity of submitting views to you once again, this time on the extremely important question of tax reform, is very much appreciated.

2. The Association commends the government for its approach to tax reform -- the issuance of a White Paper, the opportunity for public discussion of it and the study of it in depth by your Committee and the Standing Committee on Finance, Trade and Economic Affairs of the House of Commons.

3. The Association comprises 110 life insurance companies doing business in Canada. They have on their books 99% of the life insurance and annuities in force in this country.

4. This submission has three sections dealing with:

- (I) Tax reform measures directly affecting Canadian life insurance policyholders.
- (II) Tax reform measures affecting life insurance companies and, through them, company policyholders and shareholders.
- (III) Implications of tax reform proposals for saving and investment in Canada and a suggestion for inducing more saving.

Sections II and III have supporting Appendices, identified as A and B respectively.

5. The Association is not opposed to reform of the federal-provincial tax system in such ways as will not dry up the well-springs of savings and enterprise. Last June the Minister of Finance told your Committee that the life insurance tax system then enacted through Bill C-191 was the first step in tax reform and that " ... the taxes on insurance companies will bear more directly on savings than many other taxes". Studies of the impact of tax reform proposals on private saving, including Chapter 8 of the White Paper, ignore this earlier development. These life insurance taxes together with the impact of the Canada and Quebec Pension Plans have serious and adverse consequences for private saving which should not be overlooked in a capital-hungry nation. The capital shortage problem and a way of providing partial relief are sketched in Section III.

6. Members of your Committee, provincial Premiers and many other responsible analysts have drawn attention to economic and social consequences of the White Paper proposals outside the savings-investment field. Such questions deserve study in depth but they are not dealt with in this submission because the Association has no original material to contribute.

7. As indicated earlier, extensive provisions for the taxation of life insurance were added to the Income Tax Act last year by new or revised sections 68A and 79D and Parts IIF and IIIA. It was expected, therefore, that the White Paper would not propose any substantial modification of those new provisions of the Act. This appears to be the case although the White Paper proposals have inadvertently created one major dilemma for the companies which will be dealt with under Section II

of this submission. There are, of course, a number of other important provisions in the tax reform package to which the Association wishes to direct your attention.

I. Tax Reform Measures Directly Affecting
Canadian Life Insurance Policyholders

Blended Payments

8. Section 35 of the Income Tax Act now makes a tax-spreading rule available as an option to an individual who receives payments which blend income and capital. The income element in such payments can be omitted from the computation of general income and subjected to the average rate of tax applicable to that individual in the current and two preceding years. It is not clear from paragraph 2.57 of the White Paper whether the rule in section 35 is to be phased out and replaced by the general income averaging option in paragraph 2.56. That formula only applies to income in the taxation year that exceeds the average of the taxpayer's income in the preceding four years by more than one-third. The Association feels that the replacement of section 35 by the general income averaging formula would be much too harsh.

9. The blended payments affected are lump sum payments under life insurance or annuity contracts maturing or terminating other than at death and taxable under sections 7 and 79D(1)(a).

10. Many families with small and medium incomes gradually and over time build funds through endowment or other life insurance contracts with savings features with the express intent of taking the proceeds at a given point to finance a university education, a house or retirement needs. The amounts built up are not very large; the average endowment in 1969 was \$1650. The duration of endowment plans is often 20 or 30 years or longer.

11. The spreading rule in section 35 recognizes that it would be unfair to apply marginal current rates to the taxable elements built up over many years. The general income averaging formula in the White Paper

would provide no relief for many policyholders because their "gains" would not exceed one-third of current taxable income. The formula affords relief only for those receiving large amounts. Moreover, it would tax any "gains" subject to averaging at a high average marginal rate. The usual effect would be to impose heavier tax on people with small and medium incomes than if the "gain" had been taxed from year to year. The incentive to save provided by the section 35 rule would be lost.

12. The new life insurance tax system imposed last year has been followed by many policy surrenders and a depletion of investment funds that ordinarily might have gone into mortgages and bonds. Prospective withdrawal of the section 35 rule would only serve to induce more surrenders.

13. The Association recommends retention of the section 35 rule. The Association believes that section 35 has not been used by people in the higher tax brackets to avoid more tax. If there is concern on this score, the use of section 35 could be limited to periods of, say, ten years or more and, if necessary, a maximum amount of, say, \$250 per year for each year of the period.

Lump Sum Pension Withdrawals

14. The Income Tax Act now makes another tax-spreading rule available as an option in the case of various kinds of non-recurring income of an employee or his beneficiary. Included in this category are lump sum payments out of registered pension plans. Here again the income item can be omitted from the computation of general income and subjected to a special rate of tax. Under section 36 the rate is based on the average effective rate in the three preceding years.

15. Paragraph 2.57 of the White Paper proposes that the rule in

section 36 be phased out in favour of the harsher general income averaging option in paragraph 2.56 or payment into a registered retirement savings plan. In pure equity the tax paid on lump sum withdrawals should be equal to the tax not paid by reason of the original deposit into the tax-deferred saving plan. The present rule is on the average more generous than this definition of equitable treatment but the general income averaging option in the White Paper would usually result in a tax levy far heavier than the definition would entail.

16. The Association recommends that the rule ultimately adopted err in favour of the recipient rather than impose a tax penalty on pension saving. There are two further specific reasons for this view. Firstly, where a lump sum is subject to income tax as well as estate tax, a very heavy tax burden would be imposed on the same payment. The Association recommends that income tax be imposed only on the net lump sum payment arising on death, that is, after allowing a deduction for estate taxes payable. Secondly, if the White Paper proposal to deny tax credit for the tax paid by Canadian corporations on dividends accruing to a registered pension fund is implemented (paragraphs 21 and 22 of this submission advance reasons why it should not be), then this would be further and important support for the Association's view.

Withholding Tax

17. In paragraph 1.46 it is proposed that pensions paid to persons living outside of Canada be subject to a withholding tax of 25 percent "but with provision for lower or higher rates if the circumstances of the recipient warrant". This implies that the individual is expected to file a tax return in Canada or otherwise establish his tax position here and,

depending on total Canadian income, he would then pay tax on the proper basis of Canadian income. The Association believes the 25 percent rate would be higher than that payable by most pensioners. For people living on a relatively low pension, a 25 percent withholding when the actual tax rate might be nil would be taking too much out of the pensioner's current income. Admittedly, he could get a refund sometime during the next year but in the meantime he would be deprived of the use of pension monies he built up in Canada. If there are to be new withholding provisions, the Association urges that they not apply to persons now retired abroad. Many pensioners long retired simply could not afford to return to Canada to avoid a tax not levied when they made their retirement provisions years ago.

Registered Pension Plans and Savings Plans

18. The Association agrees with most of the principles expressed in the White Paper regarding pension plans. It appreciates the problems of designing an appropriate set of regulations relating to benefit rather than contribution limits and hopes to have some constructive ideas for submission when pension questions are examined separately after the White Paper is studied.

19. Assuming that full-scale review of pension rules is a year or two away, the Association suggests that the present dollar limits on contributions be raised as an interim measure. The suggestion in paragraph 2.50 of the White Paper that any limits, whether on contributions or benefits, should be kept in reasonable accord with changing circumstances gives support to this idea. The \$1500 limit for employee pension plans was effective for calendar year 1954. Adjusted by the increase in the consumer price index since then, the corresponding limit to-day would be of the order of \$2200. On the same basis the \$2500 limit for an individual not in a pension plan would be \$3500. These liberalizations should encourage some additional personal saving -- a desirable economic objective dealt with in Section III of this submission.

20. Paragraphs 2.47 and 4.60 of the White Paper suggest that there be no integration for stocks held by registered pension plans and registered retirement savings plans because tax deferment is sufficient encouragement for these plans. Hence no credit for corporate tax is to be allowed. The result is to provide only a partially tax-free build-up in these media.

21. Especially with the bias against savings in the White Paper system, the Association believes the withholding of this particular benefit from persons saving through registered media is most unfortunate. It also seems wrong in principle to discriminate against equity investment in this way.

22. In paragraph 2.52 of the White Paper it is suggested that rules are required to ensure that the trustees of a pension or retirement saving plan fund are liable and responsible for paying taxes arising out of its operations. The Association does not object to rules governing trustees in pension plans that have and should have trustees. It would object to the rules inadvertently requiring trustees for all pension plans. Trustees should not be required for a plan which is being funded solely through a contract issued by an insurance company -- whether the contract involves a group annuity, a deposit administration arrangement or a segregated account -- as long as by the terms of that policy the insurer agrees to assume any required functions relating to taxes. In Canada life insurance companies do not have the power to operate as trustees but effectively can carry out the same functions as trustees of pension funds perform. The close government supervision of life insurance companies can ensure that commitments are fulfilled.

23. Section 79B(12) of the Income Tax Act requires Ministerial approval for a transfer out of a registered retirement savings plan. This is awkward administratively for both the Department of National Revenue and a life insurance company that has the savings part of an insurance contract registered under section 79B. The Association recommends adoption of simple procedures like those provided under section 11(1)(u) for transfers from registered pension plans.

Joint Impact of Income Tax on Capital Gains and Estate Tax

24. The taxation of capital gains could in certain circumstances work a real hardship for policyholders or other individuals, because the proposals for alleviation that have been included do not seem to cover the circumstances.

25. In paragraph 3.42 it is proposed that in the case of assets owned by a deceased person's estate capital gains would not be accrued at the time of death (although estate tax will be paid on the fair market value at date of death) but only when the assets are disposed of. The executor or beneficiary would be deemed to have acquired the asset at its cost to the deceased increased by the estate tax on the capital gain. If, in contrast, assets must be realized at death there will be both an estate tax and a tax on capital gains.

26. To alleviate the problems caused by these two taxes falling at the same time the Association proposes that, in situations where there is a forced realization because of death or where underlying ownership of the asset has not changed, the taxpayer be permitted to roll over the gain. An example of forced realization to which the rollover does not seem to apply as the proposals now stand is in connection with a buy

and sell agreement where on the death of one partner or shareholder his shares must be sold to the survivor. In connection with a change of underlying ownership of assets, a rollover is permitted where a taxpayer has transferred assets to a corporation in which he owns all of the shares but it is not permitted where others, such as his children, own any of the shares of the corporation. In addition, the rollover would not seem to be applicable to assets transferred to a trust which up to now has been used extensively for estate planning purposes in the common law provinces.

27. Because the White Paper proposals do not cover these situations, the Association recommends that a credit for capital gains tax payable at death be allowed as a deduction in computing the tax on the estate. As an alternative to this the United States system might be adopted. Under that system there is no capital gains tax at death, and the beneficiary or executor takes in the asset at its fair market value at the time of death and not at its "cost" to the deceased.

II. Tax Reform Measures Affecting Life Insurance
Companies and, Through Them, Company Policy-
holders and Shareholders

Integration

(a) Present Treatment of Dividend Income

28. Under section 28(1) a corporate taxpayer is allowed to receive dividends from another taxable Canadian corporation free of tax. Under the recently enacted life insurance tax system this treatment is in effect withheld from life insurers and part of the dividends they receive on shares that are not in their segregated funds enters into their taxable income. No such treatment is imposed on or proposed for other financial institutions and other-than-life insurance companies. The treatment makes the after-tax return on a given stock investment less for life insurance companies than for other intermediaries competing with life companies for private savings. It therefore makes Canadian stocks relatively less attractive to life companies.

29. Sections 68A(6) and 105R(2)(b) of the Income Tax Act in effect prorate the administrative expenses said to relate to the savings element of fully guaranteed contracts between dividends from taxable Canadian corporations and other investment income. After that the dividends net of their share of such expenses are prorated among (i) policyholders not taxable under Part IIF (mainly those with non-participating policies when the new Part I and IIF taxes were announced, and those with registered policies), (ii) other policyholders, and (iii) the company. On the share prorated to policyholders who are not taxable there is no tax under Part IIF and no credit. On the other policyholders' share there is a 20 percent credit against the tax on investment income (Part IIF)

on the ground that the tax is in lieu of a tax on individual policyholders. Only the share deemed applicable to the company is deducted from the company's taxable income under Part I of the Act.

30. The consequence of this treatment is that if additional income in the form of dividends from taxable Canadian corporations is received by the company, the taxable income of the company is increased as if the additional income was not all from dividends but a mixture of a small part of dividends and a large part of other income. The dividend deduction then allowed is based on this small part and becomes but a fraction of the actual dividends.

31. The "interaction" between the business income tax and the tax on investment income (sections 68A(3)(a)(vii) and 105S(3)(b) of the Act) means that there is an unknown quantity under each of the two taxes. The Part I tax is based on the income of the company after deduction of the Part IIF tax. From the Part IIF tax base is deducted business income. This means that the amounts of the taxes and proportions used to do the prorating of corporate dividend income described in paragraph 29 have to be worked out by algebraic formulae. The impact of the formulae will vary within a company from time to time and between companies depending on numerous other elements in the formulae. Appendix A shows the formulae and Illustration #1 in it applies the current formulae to a hypothetical life insurance company's general funds.

32. To understand the real effect of the tax formulae on the corporate dividend income received by life companies in their general funds the marginal rate of tax must be examined. The marginal rate of tax applicable to such corporate dividend income is the additional amount of tax

resulting from one dollar of additional dividend income received with all other factors remaining constant. This rate is equal to or close to zero for other corporations. In contrast, depending upon company circumstances the present prorating treatment for life companies taxes away from one-quarter to one-half of an extra dollar of corporate dividends received. Appendix A contains a table showing the marginal rates of tax applicable to corporate dividend income in the general funds of a life insurance company.

33.. The life companies can see no real justification for this special and discriminatory treatment of dividends received from taxable Canadian corporations in the computation of their corporate taxable income. The liability of a life insurer to its policyholders under its guaranteed insurance contracts is akin, for example, to the liability of a bank or trust company to its depositors. Such institutions, however, are not required to prorate their corporate dividend income as between company account and depositors, but may claim all corporate dividends received as a deduction from corporate taxable income. While the prorating formula may have served a useful temporary purpose, the Association suggests it be dropped entirely to place the life insurance business on a basis similar to that for other institutions.

(b) White Paper Proposals

34. No indication has been given in the White Paper as to how the gross-up and tax credit integration procedures of the White Paper might equitably be superimposed upon the present complicated treatment of corporate dividends received by life insurance companies. This is the dilemma referred to in paragraph 7 of this submission. Various approaches

were examined by the Association to adapt the proposed integration treatment of dividends to the life companies' special situation. It came to the conclusion that a number of modifications would be required and that these could only be developed by means of detailed technical discussions with tax officials.

35. Whether or not the integration proposals are proceeded with, if the prorating formula is not dropped entirely the Association submits that section 68A(6) should at least be clarified, to shield from the prorating formula dividends on (i) shares held in the other-than-life account of a life insurer and (ii) shares from life company subsidiaries established under section 64A of the Canadian and British Insurance Companies Act.

36. Regarding (i) it appears that dividends on shares held in the other-than-life account are included in the dividends to be allocated under section 68A(6). As explained above, this results in only a partial deduction for such dividends from business income. In contrast, dividends on shares held in the other-than-life account by an insurer that transacts only other-than-life insurance are fully deductible under section 28(1). This is particularly unfair, for example, in the case of multi-line companies doing a large other-than-life as well as life business where the company has an extensive holding of shares in its other-than-life account. A life insurer should be allowed a full deduction from corporate taxable income for dividends on shares held in its other-than-life account just as an other-than-life insurer is.

37. Regarding (ii) the present approach means that income is fully taxed in the hands of a life company subsidiary and then taxed in part again in the hands of the life company itself. This penalizes

diversification of services through a subsidiary. The alternative is to set up a holding company with the life insurer and ancillary companies as subsidiaries. This influence of the tax laws is unlikely to find favour with government officials responsible for supervision of insurance companies.

(c) Widely-Held vs. Closely-Held Distinction

38. One obvious problem arising out of the arbitrary distinction in the White Paper between widely-held and closely-held companies is the classification of a life insurance company -- stock or mutual. Mutual life insurance companies have no shareholders at all. Yet in the interest of equitable treatment among the various types of life companies it appears all should be classed alike as widely-held if the distinction between closely-held and widely-held companies is retained.

39. If the distinction is retained, the Association also foresees problems for a life company in handling transactions with its own wholly-owned subsidiaries established under section 64A of the Canadian and British Insurance Companies Act. Particularly in the case of real estate subsidiaries either the partnership option for the subsidiary (White Paper paragraph 4.22) or the opportunity of consolidating tax returns with the parent life company should be available.

(d) Stock Companies - Special Problem

40. Paragraphs 4.27 and 4.37 of the White Paper propose that, if integration is adopted, corporations must pay out virtually all their after-tax earnings to shareholders within 2 1/2 years if the shareholder is to get credit for tax paid by the company. This "enforced pay-out" rule would limit the ability of a stock life insurance company to build needed

contingency reserves and surplus out of after-tax monies. Solvency considerations may make it impossible for life companies to pay all earnings currently to shareholders.

41. Last June the Minister of Finance observed in connection with Bill C-191 that "a particular company can run into a combination of circumstances that are even more adverse than those covered by the protection I have outlined. Indeed I expect the insurance companies to maintain free surpluses or contingency reserves ..." The Association therefore urges that if the "enforced pay-out" rule is implemented, stock life companies be exempt from it because of their special need for surplus for the protection of policyholders.

42. Of course, proponents of the rule can point out that any corporation could avoid the enforced pay-out requirement by paying out stock dividends. The Association agrees with those who question the advisability of forcing capitalization of retained earnings in this way. In addition, there is the problem of how the recipient of the stock dividend finds the cash to pay his tax on it and the consequent possibility that he would have to sell his shares and dilute or lose his ownership position. Also, the proponents might suggest that a company could "escape" the requirement by raising additional money through a stock issue. Some life companies may be confronted with charter limitations on further stock distribution. In any event, the disadvantage of diluting ownership could apply as well to the issuance of treasury stock in any corporation.

(e) Mutual Companies - Special Problem

43. Behind integration is the concept that a corporation represents a group of individuals and the individuals, not the corporation,

are the entities who really bear the tax. A mutual life insurance company pays a business income tax on its earnings yet it has no "shareholders" to whom to relay the tax credits. Much the same question applies to the participating business of stock companies.

44. There is no direct solution to this problem. However, as the law now stands the excess premiums returned to policyholders in the form of policy dividends serve to reduce the income taxable at the corporate rate and increase the Part IIF income taxable at the policyholders' rate with one important limitation. Such policy dividends must be paid from current income of the participating business (section 68A(3)(a)(iii)(B)). This in effect is a form of integration because a company could theoretically reduce its corporate taxable income to zero by retaining no contingency reserves at all. In practice of course this could not be done because the company must protect itself against insolvency in the event of adverse conditions. Removal of the limitation on the deductibility of policy dividends in section 68A(3)(a)(iii)(B) would allow a company to establish sufficient after-tax contingency reserves with the knowledge that when such reserves were eventually reduced and paid out to policyholders the tax incurred at the policyholders' rate would be compensated by a reduction in the tax at the corporate rate. As a result, no double taxation would then take place as is the case now if participating income is retained more than one year.

Capital Gains

(a) Valuation for Capital Gains

45. At the moment the Association has no fresh material to put before you in relation to the principle of taxing capital gains. There are different kinds of gains -- for example, those stemming from inflation,

from the assumption of true risk, or merely from purchases at a discount -- and deeper study might throw light on what is properly a tax-exempt capital gain and what is not. Life companies are, of course, already taxable under special rules (sections 68A(3)(b), 68A(4)(b) and 105S(1)) on capital gains and losses taken on most debt instruments.

46. The Association recommends that the gain for stocks should be measured from the market value on valuation day or the original cost, whichever is the higher. For example, if a stock were originally bought at \$50 but valued at \$30 on "V-day" (paragraphs 3.15 and 3.16 of White Paper), any subsequent sale between \$30 and \$50 would not result in a capital gain or loss. This was, in general, the treatment provided when the United States life insurance tax system was established in 1959 and also when the United Kingdom introduced its capital gains tax.

(b) Special Capital Gains Distribution

47. There is a special rule for mutual funds in paragraph 4.62 of the White Paper enabling them to make "special distributions to ... shareholders which would be treated as though they were a capital gain on the sale of a Canadian public corporation". This special rule is not available to other financial institutions such as banks, trust companies, life insurance companies or closed-end funds. All of these corporations are in the business of investing funds in the securities market and these funds may from time to time develop capital gains attributable to the shareholder.

48. It appears that all these institutions would, under the proposal in paragraph 4.59, pay a rate of 33 1/3 percent on capital gains realized on the sale of shares in other Canadian public corporations. It is perhaps proper that the 33 1/3 percent rate apply in the case of non-financial institutions as these corporations are investing surplus funds as a marginal operation. Finan-

cial institutions are intermediaries under a variety of conditions for individuals including their shareholders. It is clear in the White Paper that it is the substance, not the form, of a transaction that should be examined, that individuals should not pay more or less tax due to the form and that capital gains on equities in the hands of individuals should be taxed at no more than half-rates. The Association requests that if capital gains are to be taxed, life insurance companies be enabled to put their shareholders in the same position as if the shareholders had realized the capital gains themselves. This would mean that the special treatment outlined in paragraph 4.62 should be broadened to include life insurance companies or, alternatively, that capital gains arising from stocks should be taxed at half-rates in the hands of the life companies with full credit on distribution to shareholders.

49. The present Income Tax Act provides for the reporting and taxation of income accruing to policyholders from so-called segregated funds on a flow-through basis (section 79D). The companies have at considerable expense established routines for reporting such income to their policyholders. The present routines do not contemplate the taxation of capital gains but can be easily extended, if necessary, for this purpose. The companies believe that the objects of the White Paper proposals are presently being accomplished under the present system since the income arising from these funds is being taxed in the hands of the ultimate recipients at their individual tax rates. It is, therefore, strongly recommended that in any implementation of the White Paper proposals that this arrangement not be disturbed except to the extent of reporting in addition the amount of any capital gains or losses as accrued.

(c) Deemed Realizations

50. Paragraphs 3.36 to 3.38 of the White Paper propose as part of this broad integration and capital gains concept that accrued gains or losses on

shares of widely-held Canadian corporations be taken into account by individuals and corporations and taxed every five years. The government has issued a technical paper summarizing the basic public criticisms of this proposal, suggested modifications, and indicated the implications of such modifications and of dropping the idea. The Association endorses the general arguments against the proposal.

Company and Industry Meetings

51. There are two classes of meetings within the life insurance business -- (i) institutional meetings of company representatives, and (ii) meetings of agents, managers or other personnel of the company.

52. As regards (i), the meetings are of central organizations which perform an essential business function, particularly in the relations between the industry and governments and regulatory authorities. Such organizations can function satisfactorily only if there are regular meetings attended by representatives of the companies, the head offices of which are spread from coast to coast. Most of these meetings are of one day's duration. It is unusual for them to extend beyond two days.

53. As regards (ii), the meetings serve an essential training and education function. Most such meetings are of a strictly business nature, organized on a regional basis or at head office, and designed to inform personnel of developments in product design, estate planning and administrative procedures. In addition, many companies hold more general meetings for their leading salesmen, usually at intervals of two years or more. Such meetings fulfil a valuable business function in increasing the skills and enthusiasm of the salesmen, and giving an opportunity for an exchange of successful sales ideas in informal discussions.

54. This latter type of meeting was the subject of an appeal to the Exchequer Court by a branch manager of a member company. The Court's findings as to the nature of the meeting are relevant to the proposal in the White Paper:

"The appellant and John S. Harris, a vice-president of the company and director of agencies, as well as the officer in charge of conferences, who were the only witnesses called, testified convincingly respecting the business purpose of the biannual conferences organized by Canada Life exclusively for their personnel. Great care is exercised in selecting the site of such conferences. Among the prime considerations is the ready accessibility and minimum expense required for the personnel selected to attend...

"These conferences are Canada Life meetings called for the specific purpose of increasing the potential of the company's sales organization by instructing the members thereof on better selling methods and techniques in formal sessions and through mutual association in informal sessions.

"While at the conference the activities of the salesmen are under the control and direction of the Canada Life with a full schedule of business programmes during normal working hours...

"The salesmen who are selected to attend are so selected on a production basis, that is, those who have sold a certain amount of life insurance, in the expectation that their exposure to teaching and associations with other salesmen and managers will make them still better salesmen.

"... in my opinion the evidence conclusively establishes that these conferences are business conferences for the purpose of increasing the earning capacity of Canada Life and incidentally its salesman and managers, despite the fact that there might be some social activity."*

55. The Association believes that the proposals in paragraph 2.11 of the White Paper are based on a misunderstanding of the reasons for

*Vernon E. Hale v. Minister of National Revenue, 1969 1 Ex.C.R. 259 at 260 and 261.

meetings and urges that reasonable expenses relating to purposeful meetings designed to build the knowledge and productivity of those attending be allowed as deductions from business income.

Entertainment Expenses

56. Paragraph 2.11 of the White Paper also proposes that entertainment expense be non-deductible as a business expense. With rare exceptions the business courtesy expenses incurred by the life insurance companies are reasonable in type and amount and necessary to the development of business and the production of income. The Association urges that necessary, adequately documented business courtesy expenses be permitted as deductions against business income.

Non-Registered Pension Plans

57. Municipalities and other non-taxable employers may wish to establish non-contributory, non-registered pension plans for their employees containing guaranteed returns which only life insurance companies can provide. Part IIF of the Income Tax Act imposes tax on the investment income of non-registered pension plans issued by life insurance companies when guarantees are involved. This tax is not imposed on similar plans issued without guarantees. The Association recommends that tax relief be given in these cases.

Annuities as an Investment under Deferred Profit-Sharing Plans

58. Annuities are not referred to in section 105Q(e) of the Income Tax Act as "qualified investments" for deferred profit-sharing plan trusts under section 79C. Section 105K(6) sets out special rules relating to life insurance policies that qualify and do not qualify as investments for such a trust. This section has been interpreted to exclude annuity

contracts whether they provide fixed or variable benefits. The Association questions this interpretation and in any event maintains that annuities, whether fixed or variable, are appropriate investments for deferred profit-sharing plans.

59. These contracts would be purchased as an investment by the trust during the period before maturity of the contract in the same manner as any other investment. When the shares of the beneficiaries are distributed, the annuities could either be cashed or the annuity payments could commence to the beneficiaries as envisaged in section 79C(2)(k)(vi). It is difficult to appreciate why annuities have not been considered appropriate investments when section 79C(2)(k)(vi) makes provision for the payment out to a beneficiary to be by way of an annuity purchased by the trustee.

60. These annuity contracts fulfil satisfactorily the basic requirements of a section 79C trust. Securities provided by other financial institutions such as guaranteed investment certificates issued by trust companies, the shares of investment companies and listed shares generally are prescribed as qualified investments in section 105Q(e). The Association urges that in fairness annuity contracts be similarly prescribed.

Foreign Tax Credits

61. The life insurance taxes established in 1969 apply only to the Canadian business of the companies. However, a small part of investments relating to Canadian liabilities and surplus -- perhaps one or two percent -- is made abroad. Foreign taxes are withheld on these investments but no credit is being accorded the Canadian life companies for such foreign taxes. Section 68A(8) rightly declines foreign tax credits in respect of investments

relating to non-Canadian operations but should not apply to investments relating to Canadian operations. The Association trusts a suitable change will be made when the Act is next amended.

Non-Resident Companies

62. Under the present life insurance income tax system, non-resident insurers are in effect treated as domestic taxpayers as far as their Canadian operations are concerned. Paragraph 4.49 of the White Paper proposes as part of the integration concept not to give foreign shareholders of Canadian corporations credit for the tax paid by these corporations. If this proposal is implemented, the Association trusts it will be done in such a way that non-resident insurers will not be treated as foreign in respect of income now considered under the Act to be applicable to their Canadian operations.

63. Paragraph 3.45 of the White Paper proposes that the transfer of assets from a taxpayer to a corporation in which it owns all of the shares should qualify for a rollover free of capital gains tax. If this proposal is implemented, the law should make it clear that the incorporation of a wholly-owned subsidiary in Canada by the Canadian operation of a non-resident insurer constitutes a tax-free rollover. As in the preceding paragraph, the objective is merely to have the Canadian operations of non-resident and domestic insurers treated alike in this respect.

64. The Association has some concern about the proposal in paragraphs 6.36 to 6.39 that could later affect non-resident life insurance companies with Canadian investments in excess of those required to cover their Canadian liabilities. This proposal would increase to 25 percent the rate of tax applicable to interest paid by Canadians to non-residents

unless a tax treaty provides for a lower rate. Because the rate would apply to gross flows, the levy would far exceed that resulting from the application of the company's corporate rate to net income.

65. Non-resident life insurance companies have \$5 billion invested in Canada on behalf of their policyholders outside Canada. Most of this investment is in debt holdings rather than equities; many Canadians seem to favour debt holdings for non-residents.

66. Any increase or potential increase in the non-resident rate on interest payments would obviously lessen the attractiveness of Canadian investment to non-resident life insurance companies. The alternative of higher interest rates to compensate lenders for the increased tax would place a further burden on Canadian borrowers (see Section III of this submission). The Association urges that lenders and borrowers be re-assured through the retention of the present statutory rate.

67. Section 68A(12)(m) is designed to protect a non-resident life insurer. It allows assets brought into Canada as a temporary measure for supervisory purposes to cover a fall in market values to be withdrawn later free of tax. However, as worded now it seems to prohibit the insurer from including such assets in its Canadian operation if it wishes. One solution seems to be to replace "does" with "may" in the second line of section 68A(12)(m).

68. Also section 68A(12)(m) refers to life insurance assets only. It is suggested the same treatment should be accorded other-than-life insurance assets which other parts of the Act and the Regulations make clear are included in the tax base for life insurers.

III. Implications of Tax Reform Proposals for
Saving and Investment in Canada and a
Suggestion for Inducing More Saving

The Question for Canada

69. Paragraph 1.10 of the White Paper suggests as an objective of tax reform ensuring that "the tax system does not interfere seriously with economic growth and productivity". Surely this is the wrong approach. It should not be necessary to prove that the proposed tax reform measures seriously interfere with economic growth and productivity in order to question how appropriate they are. Canada needs new job opportunities, more capital sources, new technology and skills -- in summary, more growth. Only with growth will come a broader sharing of the fruits of growth and more social development programs of all kinds.

70. In general, Canada has adequate labour and raw material resources to support rapid growth. It is dependent, however, on external resources for part of its capital needs and technical skills. In the Association's view the overall thrust of the tax reform measures would accentuate rather than remedy these deficiencies.

71. The question for Canada boils down to a matter of elementary economic arithmetic. To maintain real economic growth the nation needs investment. This investment must be financed by real savings, either domestic or foreign. If domestic saving is cut back, without a corresponding increase of inflows of foreign capital -- if indeed they can be attracted -- Canada must sacrifice economic expansion. If at the same time, the existing level of domestic saving is inadequate, as it is now, the problem becomes doubly serious. Whether or not Canadians like this state of affairs is immaterial. The economic realities of the situation dictate that a choice between these alternatives must be made.

72. Existing attitudes among sections of the public do not make the choice any easier. Many Canadians deplore the prospect of increasing foreign ownership in the economy. Everyone deplores unemployment of people and other resources.

The Domestic Savings Gap

73. Appendix B analyzes the supply of capital in the decade ahead and the demand for it consistent with attaining Canada's full growth potential.

74. Gross national saving without the proposed tax reforms could amount to 23.7 percent of gross national expenditure over the decade ahead. Investment needs if Canada is to grow at potential represent 25.7 percent of GNE. In short, a growing Canada is confronted with a current account deficit of an estimated two percent of GNE under the existing tax system. This compares with a 1950 - 1968 average deficit of 2.1 percent.

75. Translated into dollars, the gap in domestic saving required to be filled by an external capital inflow is projected to be \$2.3 billion in 1975 and \$2.9 billion in 1979. These estimates compare with an actual inflow in 1969 of \$787 million.

76. The White Paper estimates that its proposals would reduce saving by \$150 million in the first year and \$525 million in the fifth year. Of course, the recently enacted taxation of life insurance companies will also have a negative impact on saving. The reduction in savings in the private sector from past and future tax reform -- namely the life company taxation of 1969, and the White Paper proposals -- could amount to \$250 million in the first year and \$775 million in the fifth year. These figures indicate a requirement for external capital estimated at \$3.3 billion in 1975 and \$4.4 billion in 1979. Note that the gap widens as time goes on.

77. Given the world-wide nature of the shortage of investment capital, the prospect of attracting external capital on favourable terms in this volume is not a reassuring one.

78. It is therefore of urgent concern to modify the tax reform proposals to head off this result. Fortunately there are a number of ways this can be accomplished without destroying the constructive elements of the White Paper such as increased equity and income integration.

79. A major question mark is the application of the large increase in federal tax revenues that will occur from the White Paper proposals by the fifth year of enactment. This increase has been variously estimated at between \$800-1,500 million or more in the fifth year of the new system.

80. It is recognized that government responsibility continues to grow at a rapid pace in such fields as health and welfare, education, transportation, regional development, pollution control and international aid. However, the Association is convinced that a transfer of resources in this amount from the private to the public sector runs a real risk of inhibiting the rate of growth in the economy. In the private sector a large part of the resources would undoubtedly have been saved and invested. There is no way of knowing whether these resources will be used by the government for capital purposes or spent on current programs. Consequently, until more information is available from the government regarding plans for spending this additional revenue, many Canadians must be very skeptical about the appropriateness of such a transfer. They must question the advisability of government assuming the responsibility for determining the direction of such a large additional amount of the investment resources of the country.

Savings-Incentive Program

81. The persistently wide gap that has existed and appears likely to continue to exist in the private sector between the demand for capital funds and the supply of domestic savings stresses the need for a program to stimulate a larger volume of personal saving -- a key source of capital. This conclusion is strengthened in the Association's view by the declining proportion that contractual saving*, the most stable element of personal saving, is contributing to total personal savings. Many countries interested in maintaining or increasing the contractual proportion of their personal savings flow have accorded preferred tax treatment to life insurance premiums. The Association recommends that serious consideration be given to extending some form of preferred tax status to the premiums paid by Canadian policyholders.

82. In addition, it is suggested that there is a need to introduce a more broadly based savings-incentive program. An early step would be detailed examination of such programs in countries whose basic economic and socio-political structures are like our own. While none of these programs is likely to be completely applicable to Canada's specific problem, no doubt useful ideas would emerge.

83. Specifically, any savings-incentive program should meet the following criteria:

- (i) It should promote saving at a reasonable cost in revenue.
- (ii) It should promote truly new savings, not merely shift existing flows.

*Excluding the Canada and Quebec Pension Plans (Tables 2 and 3 in Appendix B)

- (iii) It should not violate the concepts of equity and progressivity embodied in the tax reform proposals.

84. In order to meet these criteria such a program would have the following characteristics:

- (i) It would attempt to make savers of non-savers, thus yielding real increases in savings rather than subsidizing existing flows.
- (ii) It would apply to as wide a range of savings media as possible, thus minimizing the "shift" effect.
- (iii) It would be in the form of a tax credit (or exemption or rebate) on new savings flows rather than income from existing savings.

85. Taken together the characteristics imply some program designed to appeal to and benefit lower-income Canadians. Such a program would seem to be generally consistent with the aims of the tax reform proposals. The present registered retirement plan is the prototype of such a system and could be liberalized to increase the savings yield. However, there would be merit in supplementing registered plans by a scheme in which more savings media could be used for shorter durations and for broader purposes. Financing higher education or better housing are two obvious goals for savers in such a scheme. For illustrative purposes and possibly as a basis for additional research, the framework of such a scheme has been included at the end of Appendix B.

APPENDICES

- A. Treatment of Dividend Income in the Non-Segregated Life Accounts of a Life Insurer
- B. Economic Implications of the White Paper

APPENDIX A

Treatment of Dividend Income in the Non-Segregated Life Accounts of a Life InsurerContents

A. Present Tax Treatment

B. Marginal Tax Rates

A. Present Tax Treatment

Sections 68A(6) and 105R(2)(b) of the Income Tax Act in effect prorate the administrative expenses said to relate to the savings element of non-segregated contracts between dividends from taxable Canadian corporations and other investment income; after that the dividends net of their share of such expenses are prorated among (i) non-taxable policyholders not taxable under Part IIF (mainly non-participating business existing on October 22, 1968, and pension business), (ii) other policyholders, and (iii) the company.

On the share of policyholders who are not taxable under Part IIF there is no tax and no credit; on the other policyholders' share there is a 20 percent credit against the tax on investment income (Part IIF) on the ground that that is in lieu of a tax on individual policyholders; the share of the company is deducted from the company's taxable income under Part I of the Act.

The proportions used to do the prorating have to be worked out by algebraic equations because they must be such that the share of all investment income going to the company must equal the income of the company after deduction of the Part IIF tax which itself depends on the share of all investment income going to taxable policyholders.

TAX FORMULAS

Records and preliminary work must produce the following summary items for "Canadian Life Insurance". This excludes other-than-life insurance

except as regards D below but, of course, the other-than-life profit or loss of a life insurer is later brought into the insurer's taxable income.

Let I = "Taxable Canadian life investment income" per section 105S(3) before the deduction for insurer's "income" computed in accordance with Part I and allowed by section 105S(3)(b).

G = Part I "income" per section 68A before the deduction for Part IIF tax allowed under section 68A(3)(a)(vii).

D = dividends received on non-segregated accounts from taxable Canadian corporations (it appears these dividends do not relate solely to "Canadian Life Insurance" and include dividends on all shares held for non-segregated life and for other-than-life accounts).

P^I = the Part IIF credit for premium taxes under section 105R(2)(a).

C = the Part I deduction for charitable donations on life account under section 27(1)(a).

L = the Part I loss carryover for life insurance under section 27(1)(e).

S = the addition to Part I taxable income in respect to shareholder dividends pursuant to section 68A(7).

r = corporate tax rate in Part I (from statute).

PH = policyholder amounts specified in section 105S(3)(c).

E = exempt amounts of "interest elements" specified in section 105S(3)(a).

A = administrative expenses specified in section 105S(2)(d).

Formulas are then used to produce the following five items needed for completion of the life insurance part of the tax:

D^I = the portion of dividends received from taxable Canadian corporations for which a 19.4% tax credit is allowed in Part IIF, section 105R(2)(b).

D^G = the portion of dividends received on non-segregated accounts from taxable Canadian corporations allowable as a deduction under Part I, section 68A(6).

I^1 = Part IIF "taxable Canadian life investment income" - section 105S(3).

G^1 = Part I "income" from life insurance - section 68A.

G^2 = Part I "taxable income" from life insurance - section 68A.

Using only known quantities, solve for

$$I^1 = \frac{I - G - \frac{.194D (PH)}{I+A+E+PH} - P^I}{.85 + \frac{.194D}{I+A+E+PH}}$$

Then knowing I^1 solve for

$$D^I = D (I^1 + PH) / (I + A + E + PH)$$

Now knowing I^1 and D^I solve for

T^I or Part IIF tax (after credits) = $.15I^1 - .194D^I - P^I$ (section 105R(1) and (2))

and $G^1 = G - .15I^1 + .194D^I + P^I$

Now knowing G^1 solve for

$D^G = D (Z) / (I + A + E + PH)$ where Z is the lesser of G^1 or $(I + PH)$

and $G^2 = (G^1 - .97D^G - C - L + S)$

ILLUSTRATION #1

Figures for a hypothetical company are used in the following illustration of the formulae.

* D	\$ 4,756	- dividends received in non-segregated account from taxable Canadian corporations
* I+A+E+PH	70,896	
* A	11,374	- deductible administrative expense

* E	\$14,700	- exempt investment income (re pre-existing and registered business)
* PH	<u>30</u>	- income taxed in policyholders' hands
* I	44,792	- taxable Canadian life investment income
G ¹	<u>10,043.94</u>	- Part I business income after adjusting for Part IIF tax
I ¹	34,748.12	- Part IIF taxable Canadian life investment income
15% of I ¹	5,212.22	- Part IIF tax before credits
* P ^I	445.50	- Part IIF credit for premium taxes
.194 D ^I	<u>452.66</u>	- Part IIF corporate dividend credit (.194% of element (i) in narrative above)
T ^I	4,314.06	- Part IIF tax on investment income
* G	14,358	- Part I business income before adjusting for Part IIF tax
T ^I	<u>4,314.06</u>	- Part IIF tax
G ¹	10,043.94	- Part I business income after adjusting for Part IIF tax
.97 D ^G	<u>653.71</u>	- Part I corporate dividend deduction (.97% of element (iii) in narrative above)
G ²	<u>9,390.23</u>	- Part I taxable income
T ^G i.e. 52% of G ²	4,882.92	- Part I tax on business income
T ^I + T ^G	<u>9,196.98</u>	- Part IIF and I taxes

* Known data

$$R^I = 49.06\%$$

- Ratio of the sum of taxable Canadian life investment income and policyholder amounts specified in section 105S(3)(c) to $I+A+E+PH$ (ratio in section 105R(2)(b))
- OR portion of corporate dividends prorated to policyholders -- see (i) in first paragraph of Appendix

- the formula for it is

$$\frac{I^1 + PH}{I+A+E+PH}$$

$$R^G = 14.17\%$$

- Ratio of Part I business income after adjusting for Part IIF tax to $I+A+E+PH$ (ratio in section 68A(6)(b)) OR portion of corporate dividends prorated to company -- see (iii) in first paragraph of Appendix
- the formula for it is

$$\frac{Z}{I+A+E+PH}$$

where Z is the lesser of (i) G^1 or (ii) $I + PH$

To indicate that the hypothetical figures used are realistic, the last-mentioned ratios for four companies represented are:

	<u>R^I</u>	<u>R^G</u>
Company 1	49%	14%
2	47	12
3	37	8
4	33	27

The effect of the formulae is to allocate the dividends (\$4,756)

as follows:

	Non-taxable Policyholders (E)	Other Policyholders (I)	Company (G)	Total
Dividends	\$1,174.25	\$2,778.93	\$ 802.82	\$4,756.00
Share of Administration	188.32	445.63	128.91	762.86
Net Income	985.93	2,333.30	673.91	3,993.14
Company Deduction *(.97 D ^G)			653.7	
Policyholder Credit *(.194 D ^I)		452.66		

*Section 68A(6) and 105R(2)(a) apply only to 97% of dividends because investment expense on dividends is arbitrarily set as 3% of the net income therefrom.

B. Marginal Tax Rates

The life insurance companies question the rationale behind the prorating technique in the present tax formulae for a variety of reasons. One of the reasons is best illustrated by examination of the marginal tax rate on dividends.

Assume that the dividends from taxable Canadian corporations received by the hypothetical company in Illustration #1 increase by \$1000.

ILLUSTRATION #2

		Change from Illustration #1
D	\$ 5,756	+ 1,000
I+A+E+PH	71,896	+ 1,000
A	11,374	

		Change from Illustration #1
E	\$14,700	
PH	30	
I	45,792	+ 1,000
G ¹	11,144.9	+ 1,101
I ¹	34,647.0	- 101
15% of I ¹	5,197.0	- 15.1
P ^I	445.5	
.194 D ^I	538.1	+ 85.4
T ^I	4,213.4	- 100.6
G	15,358	+ 1,000
T ^I	4,213.4	
G ¹	11,144.5	+ 1,100.6
.97 D ^G	865.4	+ 201.7
G ²	10,279.1	+ 888.8
T ^G (52% of G ²)	5,345.1	+ 462.2
T ^I + T ^G	9,558.5	+ 361.5

(decimals do not add due to rounding)

$$R^I = 48.19$$

$$R^G = 15.50$$

As dividend income increases, R^I and R^G change which effectively redistributes all income between the three participants (E, I and G). As a result increased dividend income in a life company attracts a high rate of additional taxation. This occurs despite the fact that the "other policy-

holders" (I) receive a 19.4 dividend credit against a tax rate of 15% and the company (G) receives a 97% deduction. The result is neither logical nor equitable

The following table gives rates of combined tax resulting from the receipt of additional income in the form of dividends from taxable Canadian corporations under various assumptions.

The rates are given as a function of three variables: R^G , R^I and "h", which is the ratio of the dividends to taxable Canadian life investment income of the life insurance company.

For the hypothetical company in Illustration #1, the variables are R^I 49%, R^G 14.2% and h 7%. Its marginal rate would be 36.8 percent which is close to the rate in the table when R^I equals 50 percent, R^G equals 15 percent and h equals 5 percent. In other words, 36.8 cents of an extra dollar of dividend income in this company is taxed away. The table shows that, depending on the company's three variables a quarter to a half of an extra dollar of dividends can be taxed away. In a bank, trust company, other-than-life insurance company or another financial institution, such income is received by the institution free of tax

MARGINAL RATES OF TAX ON DIVIDENDS
FROM TAXABLE CANADIAN CORPORATIONS
(Part I tax and Part IIF tax combined)

h = company's ratio of dividends to taxable Canadian life investment income

R^G = share of corporate dividends prorated to company

R^I = share of corporate dividends prorated to policyholders

Percentage

R^G	R^I	h			R^G	R^I	h		
		0%	5%	10%			0%	5%	10%
0%	100%	41.0	38.4	35.8	20%	80%	33.1	31.0	29.0
	75	43.8	41.2	38.6		75	33.7	31.6	29.5
	50	46.5	43.9	41.4		50	36.4	34.4	32.3
	25	49.3	46.7	44.2		25	39.2	37.1	35.1
5%	95%	39.1	36.6	34.1	25%	75%	31.2	29.2	27.2
	75	41.3	38.8	36.3		50	33.9	32.0	30.0
	50	44.0	41.5	39.1		25	36.7	34.7	32.8
	25	46.7	44.3	41.9					
10%	90%	37.1	34.7	32.4	30%	70%	29.2	27.3	25.5
	75	38.7	36.4	34.1		50	31.4	29.6	27.8
	50	41.5	39.1	36.8		25	34.1	32.3	30.5
	25	44.2	41.9	39.6					
15%	85%	35.1	32.9	30.7	35%	65%	27.2	25.5	23.8
	75	36.2	34.0	31.8		50	28.9	27.2	25.5
	50	39.0	36.7	34.6		25	31.6	29.9	28.3
	25	41.7	39.5	37.4					

Economic Implications of the White PaperContents

A. The Environment

B. Supply of and Demand for Capital in Canada

Domestic Saving

1. Sources of Domestic Saving and Their Cyclical Variability
2. Personal Saving
3. Projection of Aggregate Domestic Saving 1969-79 (excluding White Paper Effects)

Domestic Investment

1. Introduction
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- C. Expected Effect on Savings and Investment Projections of Tax Changes
- D. Financing the Investment Gap
- E. Conclusion and Alternatives

A. The Environment

In its summary of tax reform objectives, paragraph 1.10 of the White Paper states:

"The second main objective of tax reform is to see that the tax system does not interfere seriously with economic growth and productivity. Taxes by their nature cannot always promote all

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our economic goals, but they should interfere as little as possible with incentives to work and invest and with the direction our economy follows in meeting demands of consumers and foreign markets".⁽¹⁾

This statement seems to be the wrong way around. Surely it should be possible to aim at maximizing growth and productivity without interfering with fairness and compliance. It should not be necessary to prove that the proposed tax reform measures seriously interfere with economic growth and productivity in order to question their appropriateness. Canada needs to create and finance new jobs at an unprecedented pace, and build corporate structures of a size and competence to capture a growing volume in an increasingly competitive world market. A vigorously independent Canadian economy depends crucially on creating an economic and financial climate conducive to accelerated growth. A broader sharing of the fruits of growth follows naturally. Such an emphasis on growth may be inappropriate for more highly developed and mature economies but is vital for Canada. This nation has adequate labour and raw material resources to support rapid growth. It is dependent, however, on external resources for a portion of its capital needs and technological skills. In the Association's view, the overall thrust of the tax reform measures would accentuate rather than remedy these deficiencies.

It would be years before the full impact of the comprehensive tax system proposed in the White Paper would be felt. The effects must be appraised in the light of prospective economic and financial trends in the economy in the decade ahead. In a 1967 brief to the Government in connection with the Report of the Royal Commission on Taxation, the Association analyzed demographic, investment and savings trends and used them as the background for appraising

(1) White Paper on Tax Reform paragraph 1.10

the tax proposals of that Report. An updating of these trends confirms the general pattern of economic and financial developments foreseen at that time:

1. A world outlook in which governments will be forced to counter inflationary rather than deflationary pressures.
2. A world in which demands on financial resources will persistently press against available savings.
3. In Canada, specifically, an economy that will continue to require increasingly large amounts of capital to attain maximum growth rates and finance insistent social needs such as housing, education and health.
4. In Canada, a volume of domestic savings falling short of capital demands, thus extending the post-war pattern of heavy reliance on inflows of non-resident capital.
5. Growing demands for capital in the United States and Europe which will seriously limit Canada's access to these markets.
6. A strong investor trend out of bonds into equities.

These factors, combined with upward price and cost trends in Canada, suggested the need for government policy directed toward countering inflationary pressures and toward increasing the personal proportion of total domestic saving.

The White Paper proposals differ in some major respects from those of the Royal Commission. However, they continue in a form that seems bound to depress the rate of return on a wide range of investment activities and the accumulation of savings in the private sector.

The White Paper proposals differ from those of the Royal Commission in the large transfer of income -- variously estimated at between \$800 to \$1,500 million -- from the private to the government sector.

No statement has been made about the government's planned use of this extra revenue. There is therefore much scepticism about the prospects of making such a transfer without impeding growth not only in the private sector, but in the economy as a whole.

This Appendix examines the prospective supply of and demand for capital in the decade ahead consistent with attainment of Canada's full growth potential and appraises the impact of the tax reform proposals on the required level of both investment and savings.

B. Supply of and Demand for Capital in Canada

Domestic Saving

1. Sources of Domestic Saving and their Cyclical Variability

The most important source of gross, as distinct from net, domestic saving in the post-war period has been business saving. This includes depreciation allowances of corporations, government business enterprises, unincorporated business and residential dwellings plus undistributed corporate profits. From 1950-68, saving from this source averaged 15.2 percent of gross national expenditure.⁽²⁾ Corporate profits vary greatly from time to time. In contrast, depreciation allowances are quite stable. The latter are directly related to the capital stock which increases or decreases fairly slowly and fluctuates little over time.

The government budget on a national accounts basis has been in a surplus position in roughly half of the years since 1950. More significantly, however, is the fact that the budgetary position has tended to vary positively with economic conditions, improving during periods of expansion and worsening

(2) See Table 1. The averages exclude the immediate post-war adjustment years 1946-49.

during times of cyclical contractions. From 1950 to 1968 the government sector, net of government fixed capital formation, was neutral in the savings picture with capital claims equalling 0.1% of GNE.

Personal net saving has been the largest source of net domestic saving, averaging 3.7% of GNE from 1950 to 1968. Personal net saving tends to vary positively with the business cycle. In recent years, automatic stabilizers such as unemployment insurance, transfer payments and progressive tax rates on personal incomes have helped to insulate disposable income from cyclical fluctuations in the economy. However, when the income of individuals falls, they cannot cut their spending proportionately, at least in the short run. Thus, a decline in income will lead to a relatively larger decline in saving. Similarly, consumption will rise relatively less than income during a cyclical expansion so that saving as a percentage of income will rise.

It should be noted that such changes in the marginal propensity to consume are short-term in nature and that the consumption function has been relatively stable in the long run. However, this stability assumes a set of underlying conditions which are themselves relatively stable. Given a new tax system such as that proposed in the White Paper, will the traditional ratio of saving to income still apply? Several of these changed conditions will be referred to later when the effects of the White Paper on personal saving are considered.

2. Personal Saving

In Canada, as in most countries with a similar political and economic structure, the major source of net savings is the personal sector. That is, government saving usually closely matches government investment and personal saving fills the gap between corporate saving and investment. The only other

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thing which may fill this gap is foreign capital. Will increasing volumes of foreign borrowing be available to Canada throughout the 1970's? In view of Canada's mounting capital requirements in the decade ahead, the savings behaviour of the personal sector will be the crucial determinant of the extent to which the nation is able to reach the potential which the Economic Council sees ahead. Canadians must at least maintain the relative size of domestic personal saving if they are to sustain sufficient economic growth to make the other aims of the tax reform proposals, namely, government revenue for socially necessary expenditures and increased taxation equity, viable prospects over the next decade.

There are three factors, apart from the proposals for tax reform, which deserve special attention in examining the likely course of personal savings behaviour over the next ten years. The first of these is demographic. The Economic Council estimates that over the 1970's population growth will be heaviest in the 15-29 age group -- generally heavy spenders. Growth in the 0-14 age group - for which more is spent than saved -- will slow. However, the relative increases in those two age groups, other things being equal, will tend to depress the rate of saving in Canada during the 1970's.

A new factor is the increased importance of pension plans, both private and public. Over the last part of the 1960's such plans rapidly built up their assets and contributed in a major way to the stream of savings. As these plans mature, however, the excess of receipts over payouts should diminish markedly. Perhaps more important than this aspect is the socio-economic impact that the existence of public plans is likely to have. These plans, as well as various income maintenance programs, provide a greater degree of security for the Canadian public. To the extent that personal saving is undertaken to

provide just such security, a further negative thrust toward savings in the private sector has been imparted by their introduction.

One further factor must be considered although its net impact is a matter of speculation. To the extent that Canadians do in fact enjoy rising real incomes over the next decade consideration must be given as to how savings behaviour will vary with income. The evidence on this point is contradictory. As indicated earlier, in the short run as income goes up, saving goes up. However, studies of longer patterns are, in general, inconclusive. If people feel sure of not losing their new higher incomes they may live up to them and not save as much. It may be important to note that United States saving rates are generally lower than Canadian so that on balance some negative impact in this area is possible. In any case this area bears close observation in the future.

Tables 2 and 3 outline the composition and relative growth rates of the major institutional forms of personal saving in the period 1962-1968. The following observations can be made:

1. While net private saving has grown at faster annual average rates than GNP (11.7% vs. 9.1%) an even faster pace of capital investment has required a persistent heavy reliance on foreign capital inflows.
2. The share of personal saving in the total of net private saving has been increasing, indicating greater reliance on this form of saving.
3. Excluding savings arising from the Canada and Quebec Pension Plans, contractual saving has been declining as a percentage of personal saving. This trend is disturbing.

Since statistical data for extended periods are not available,

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conclusions in this area must be tentative. It does appear, however, that contractual saving, in particular saving through life insurance and pension funds, provides the greatest element of stability in the flow of personal saving. The regularity of contributions ensures the relative stability of these components of personal saving.

Referring to a recent OECD study of capital markets,⁽³⁾ The Economist stated:

The OECD study underlines the importance of efficiently functioning capital markets which can mobilize savings and make them available for investment. It points to the need to enlarge the capital markets of member countries in order to permit a substantial growth in investment and output. The importance of contractual savings to which contributions are made on a regular basis is stressed because they provide an element of stability in the market and make for higher efficiency. In Britain institutional investors have, through the scale of their activities in the market, provided a steady flow of demand -- informed and thoughtful -- over a wide range of securities and other investments.⁽⁴⁾

Available data on mutual funds are insufficient to draw firm conclusions about the cyclical characteristics of this form of saving. The experience in the first halves of 1967 and 1969, along with United States data, however, seems to indicate that in periods of credit stringency, there may be relatively severe fluctuations in net saving from this source.⁽⁵⁾

3. Projection of Aggregate Domestic Saving 1969-79 (excluding White Paper Effects)

In projecting total domestic saving over the next decade, it is assumed that the Canadian economy will be operating close to its potential. Expressed as a percentage of GNE, the components of total saving are estimated

(3) "Improving the Workings of Capital Markets". The OECD Observer, April, 1967.

(4) The Economist, July 29, 1967

(5) "Mutual Funds Net Sales Drop as Redemptions Rise", Financial Post, Aug. 5, 1967 - also net sales and redemptions data in U.S. Federal Reserve Bulletins and releases of the Canadian Mutual Funds Association.

as follows:

	<u>% of GNE</u>	
Persons and unincorporated business		
- saving	3.9	
- depreciation	<u>4.7</u>	8.6
Corporate and government business enterprises		
- depreciation	6.1	
- undistributed profits	<u>4.1</u>	10.5
Inventory valuation adjustment		<u>-0.5</u>
Total private saving		18.6
Government saving - gross		<u>5.1</u>
- net		23.7

Let us discuss each component.

The above estimate of personal saving is considerably above the 3.7% 1950-68 average. Personal net saving has averaged 4.2% of GNE over the period since 1962. Personal saving tends to rise relative to income as the economy approaches full employment. Since the economy is assumed to be operating close to potential, similar to the 1962-68 experience, a relatively high level of personal saving is to be expected. Secondly, introduction of the Canada and Quebec Pension Plans has probably produced, at least for a time, a small net increment in total saving since the fall in saving through private pension plans might not fully offset contributions to the government plans. On the other hand, as noted previously, a relatively strong inflationary trend underlying the economy is expected. If consumer prices should continue to rise at the current rate for an extended period, some adverse effect on personal saving would likely be forthcoming. In addition, the increasing proportion of the

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population being made up by young (high consumption, low saving) age groups will be a negative factor bearing on savings. These are the reasons for the estimate of 3.9%. Saving through depreciation of unincorporated business will likely stay at 4.7% of GNE -- the 1950-68 average.

Excluding the effect of tax changes, there should be no change in corporate saving through capital consumption allowances from the historical average of 6.4% of GNE. Undistributed corporation profits, while subject to substantial variation from year to year, will likely maintain their historical share of 4.1% of GNE. In sum, it is estimated that, given an average inventory valuation adjustment of -0.5% of GNE, total private saving will thus average 18.6% of GNE.

Since it is being assumed that the economy will operate at a relatively high level during this period, the generation of "fiscal dividends" might suggest large government net saving. To the contrary, projections by the Tax Structure Committee for the Federal-Provincial Conference in February, 1970, revealed that existing expenditure programs, with no new programs or tax increases, by all levels of government will create a deficit in 1971-72 of \$1.75 billion. The Minister of Finance has stated that government revenues and expenditures will continue to increase relative to GNP in the next several years. Finally, the Ontario Taxation Committee Report has estimated that by 1974, the provincial and local governments of Ontario will be operating with a combined budgetary deficit of \$1.1 billion, compared to \$362 million in 1966.⁽⁶⁾ Consequently, the small negative figure of 0.1% of GNE registered by government saving over the period 1950-68 could be greatly exceeded.

The Economic Council estimates government investment in 1975 equal to

(6) Ontario Taxation Committee Report, Chapter 6, Appendix Table 6 - 27.

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5.1% of GNE, compared to 4.6% in 1967.⁽⁷⁾ To give even a bare balance on a national accounts basis, gross government saving would thus have to total 5.1% of GNE, compared to the 3.8% 1950-68 record. It is difficult to accept that government saving and investment will balance. Nonetheless, it has been conservatively assumed here that a balance will be attained.

Thus, as shown in the table above, total gross national saving could amount to 23.7% of GNE over the decade to 1979. This compares with an Economic Council estimate of 24.3%⁽⁸⁾ by the middle of the decade (assuming a rather unlikely volume of government net saving equal to 0.4% of GNE).

Domestic Investment1. Introduction

Excepting in periods of prolonged subnormal business activity, investment expenditures have made up a relatively large part of total Canadian expenditures. Table 4 indicates that gross domestic investment averaged 24.3% of GNE from 1950 to 1968, a somewhat higher percentage than in many other developed countries. One reason for such a relatively high level of investment spending has been the development of vast and complex resource industries. Another factor has been low population density which requires large per capita expenditures for infra-structure such as transportation and communication facilities. The colder climate also requires more expensive types of construction. The earlier environmental section of this Appendix touched on Canada's continuing needs for a high level of investment to promote adequate economic growth.

According to the national accounts classification, non-residential

(7) Economic Council of Canada, Sixth Annual Review, page 94

(8) Ibid, page 94

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construction plus machinery and equipment have been the largest type of investment, averaging 14.1% of GNE from 1950 to 1968. Residential construction accounted for 4.9%. A slightly different classification of investment expenditures is shown for selected years in Table 5. It might be noted that private business enterprises generally account for half of fixed investment with the other half originating in the private non-business sector (chiefly housing) and the public sector (including government business enterprises).

As expected, the ratio of private business investment to GNE is highly cyclical, increasing in prosperous times and decreasing as the economy contracts. Inventory investment displays similar behaviour. In contrast, there is some evidence especially in 1958-59 and the last several years, that residential construction as a percentage of GNE moves contra-cyclically. This stems, of course, from the vulnerability of residential mortgage financing to credit conditions. It is also to be noted that increased public investment appears to have been made partially at the expense of private non-business investment.

Finally, since domestic investment has exceeded domestic saving, Canada has had to rely on net foreign saving in the form of a deficit on current account.

2. Financing Domestic Investment

The facts in this section emphasize Canada's dependence on fixed-income capital to finance domestic investment. Housing, of course, is financed largely through mortgage funds. Mortgage loans held by lending institutions, governments and corporate lenders increased from just over \$1 billion in 1947 to over \$19 billion in 1967. More than three-quarters of this total applies to residential property. Bank of Canada data reveal that net new Government of Canada bond

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issues from 1950 to 1969 inclusive totalled \$6.5 billion, provincial net new issues totalled \$15.9 billion, and municipal net new issues were \$5.3 billion.

During the same period, net new corporate bond issues were \$11.6 billion. On the other hand, net new issues of preferred stock totalled \$1.4 billion and of common stock, \$6.0 billion. The major sources of corporate funds, according to newly revised DBS data, were corporate capital cost allowances of about \$43.6 billion and undistributed corporate profits of an estimated \$31.6 billion. Relatively little business capital financing has been in the form of public equity issues. Moreover, reliance on this type of financing has not increased during the post-war period, despite a substantial decrease in the cost of equity capital relative to debt capital.

As suggested earlier, rising living standards and the response to social needs have generated and will continue to generate large capital demands related to housing, schools, hospitals and recreational facilities. Increasing urbanization will require additional spending for transportation facilities, urban redevelopment and pollution control, all of which will require substantial amounts of capital largely in fixed-income form.

3. Projection of Aggregate Domestic Investment - 1969-79

The estimated components of domestic investment over the next decade can be summarized as follows:

	<u>% of GNP</u>
Nonresidential construction plus machinery and equipment	14.7
Residential construction	<u>4.9</u>
Business gross fixed investment	19.6
Inventory investment	1.0
Government gross fixed investment	<u>5.1</u>
	25.7
Current account deficit	2.0
(Domestic financing of total domestic investment)	(23.7)

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The Economic Council projected business gross fixed investment at approximately 19.5% of output by the mid-1970's⁽⁹⁾ of which 4.4% would go into residential construction and 15.1% for business plant and equipment. The Economic Council's 4.4% estimate for residential construction is undoubtedly too low: since 1950 the average has been 4.9% of GNE while even the 4.5% registered from 1965 on has been entirely inadequate, as shown by the present housing crisis in many areas. Thus it is estimated here that at least 4.9% of Canada's output will have to be directed into the housing field over the next decade. At the same time, the Economic Council expects business plant and equipment outlays to expand somewhat faster than the 1950-67 average of 5.7% per annum (in constant dollars) though not quite as quickly as the average 1961-67 rate of 9.4%.⁽¹⁰⁾ In a reversal of Canadian experience through most of the post-war period, outlays for new machinery and equipment are expected to grow more rapidly than expenditures on nonresidential construction. However, the estimated outlay of 15.1% of GNE for business plant and equipment at potential in 1975 has been exceeded in only three post-war years and may thus be somewhat high. This is especially so given the expected lower emphasis on nonresidential construction with its tendency towards rising unit costs. Thus an estimate of 14.7%, equal to the 1967 experience, and approximately half way between the 14.1% 1950-68 average and the Economic Council projection should be quite conservative.

Inventory investment is taken as 1.0% (as inventory management improves). Government fixed capital formation is taken at 5.1%. This is considerably higher than the 4.5% average of the last five years, but it is still quite conservative as it is based essentially on projections of existing programs with no allowance for any new initiatives. These components bring total domestic investment over the next decade to 25.7% of GNE.

(9) Economic Council of Canada, Sixth Annual Review, 1969, page 94

(10) Ibid, page 96

If domestic investment averages 25.7% of GNE whereas domestic saving averages 23.7% of GNE, Canada can expect a current account deficit of about 2.0% of GNE compared to the 1950-68 average of 2.1%. Given a growth rate in GNE of 6 $\frac{1}{2}$ % (the 1948-69 record was 8.5% but it is assumed that future growth will not be as inflationary as in the past), the deficit in 1975 would be \$2.3 billion and in 1979 would be \$2.9 billion.

C. Expected Effect on Savings and Investment Projections of Tax Changes

In the October, 1967, submission made by The Canadian Life Insurance Association to the Minister of Finance regarding the Report of the Royal Commission on Taxation it was stated that "our studies indicate that over the next decade the demand for capital funds will continue to exceed the supply of domestically generated savings". The estimates suggested that by 1976 the capital demands of a full employment Canadian economy would exceed total domestic savings by \$1.6-2.0 billion, implying increased reliance on net capital inflows. Trends since 1967 have validated that earlier analysis. The outlook for the future, according to recent estimates, is for a continuation and intensification of the present situation. Total domestic savings could fall short of investment requirements by \$2.9 billions in 1979, quite apart from any White Paper effects.

The White Paper estimates that its proposals would reduce personal savings by \$30 million in the first year and \$75 million in the fifth. Adding these to the estimated reductions in corporate saving and the offsetting

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increases in saving out of the credit for corporate tax by shareholders, there would be a total reduction of saving amounting to about \$150 million in the first year of the new system and \$525 million in the fifth, based on 1969 income levels.

In addition, the taxation of life insurance companies has clearly had a negative impact on personal saving. In the first place, the first full year tax bill for the industry has been estimated at \$75-\$100 million and this amount will grow yearly as the business grows and adjusts to the tax burden. In addition, as observed in the Association's submission regarding the Report of the Royal Commission on Taxation (pages 32-34) there will be additional indirect negative effects on savings. These were estimated at that time to be of the order of \$150 million after five years. While too short a time has elapsed since imposition of the tax to measure its impact accurately, preliminary experience gives no reason to lower this estimate.

When the direct and indirect effects of life insurance company taxation are added to the White Paper estimates of reductions in domestic savings resulting from its taxation proposals alone, total national savings would be reduced below what otherwise would have been generated by \$250 million in the first year and \$775 million in the fifth, on the basis of 1969 incomes. These sums equal, respectively, 0.32% and 0.99% of 1969 GNE.

In sum, recent and proposed tax reform would lower the proportion of domestic investment financed by domestically generated savings and increase the proportion having to be financed by foreign sources, assuming Canada's growth program is to be met over the next decade. From an average 2.0% of GNE, as previously estimated, capital inflow would have to rise to 2.3% (in the first year) and 3.0% (in the fifth) of GNE.

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Assuming: (1) the increase from 2.3% to 3.0% of GNE were to take place smoothly at 0.14% each year for five years; (2) the target date of January 1, 1971 for application of the White Paper proposals is in fact met; and (3) there is no additional increase beyond the 3.0% level of GNE, a projection can be made of the future current account deficit implied by Canada's investment program and the expected shortfall of domestic savings. These calculations incorporate the assumptions about growth of GNE outlined at the end of Section 3. The calculations are understated to the extent GNE is underestimated, to the extent the White Paper has underestimated its effects on saving, and to the extent the White Paper proposals imply continued reductions of savings beyond 0.99% of GNE after the fifth year.

Estimates of Canada's Current Account Deficit Required to Fulfil Investment Needs
(Billions of Dollars)

	<u>Implied GNE at 6³/₄% Growth</u>	<u>Implied Current Account Deficit Without White Paper and Without Life Company Taxation</u>	<u>Implied Current Account Deficit with White Paper and Life Company Taxation</u>	<u>Difference</u>
1971	88.58	1.77	2.04	0.27
1972	94.34	1.89	2.30	0.41
1973	100.47	2.01	2.59	0.58
1974	107.00	2.14	2.91	0.77
1975	113.96	2.28	3.26	0.98
1976	121.36	2.43	3.64	1.21
1977	129.25	2.59	3.88	1.29
1978	137.65	2.75	4.13	1.38
1979	146.60	<u>2.93</u>	<u>4.40</u>	<u>1.47</u>
Cumulative Total		20.79	29.15	8.36

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D. Financing the Investment Gap

The cost of recent and proposed tax reform in terms of domestic savings amounts to \$8.36 billion over the period 1971-79. The question then arises: how would Canada finance the investment required to generate needed non-inflationary growth of incomes and employment? Theoretically, current account deficits can be financed by running down foreign exchange reserves or by attracting net capital inflows. As Canada's foreign exchange reserves totalled \$3.3 billion at the beginning of 1970, or less than half the cumulative deficit implied by the White Paper, reducing them is obviously no real solution.

Thus the White Paper proposals would seem to require much higher capital inflows, reaching \$4.4 billion a year by 1979, compared to the \$2.9 billion needed without the White Paper. Even \$2.9 billion is a staggering sum. It is not enough to say that the White Paper proposals would reduce savings "only" by \$525 million in the fifth year, out of a \$14 billion total in 1969. When \$14 billion worth of savings is already inadequate, even a 3 3/4% reduction is significant!

It was suggested in the Association's brief on the Report of the Royal Commission on Taxation that Canada should not place too much reliance upon international sources of capital because of various developments that were making continued access to substantial volumes of foreign capital less certain. Given continued domestic concern over the level of foreign ownership of Canadian industry and resources, it is apparent that many Canadians would be disturbed by the volume of capital inflow implied by the White Paper proposals if indeed the capital could be obtained. Thus the choice for Canada becomes clear: by reducing domestic saving the nation must accept either an acceleration of the trend towards foreign ownership, or a lower rate of growth

in incomes and higher unemployment. In fact, to the extent that stepped-up capital inflows cannot be easily obtained, there will be no choice at all because the latter alternative of restricted growth will be the only one available.

E. Conclusion and Alternatives

The White Paper proposals would reduce a level of domestic savings that is already inadequate in the face of Canada's requirements for investment. Thus opportunities for more jobs and higher incomes would be stifled. The only other way of ensuring that the requisite level of economic growth is maintained would be by encouraging much greater inflows of foreign capital. The White Paper assumes there may be some moderate increase in such flows but admits the change would not be large. This Appendix suggests that the improvement would likely be even more modest and might not even be forthcoming at all. Present trends in international capital markets suggest it may become more difficult to maintain capital inflows even at present levels. However, even if greater capital inflows could be induced, public sentiment seems to question the desirability of increased foreign ownership in the Canadian economy.

The question thus boils down to a matter of elementary economic arithmetic. To maintain real economic growth Canada needs investment. This investment must be financed by real savings, either domestic or foreign. If Canada cuts back on domestic savings, while not wanting or being unable to obtain a corresponding increase in foreign capital inflows, Canada must sacrifice economic expansion. If, at the same time, the existing level of domestic saving is inadequate, as it is now, the problem becomes doubly serious.

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Whether or not Canadians like this state of events is immaterial because the economic realities of the situation dictate that a choice between these alternatives must be made.

The White Paper proposals would reduce the future level of savings and investment in the private sector of the economy but the need for non-inflationary growth clearly calls for continued large additions to both private savings and investment. This argues strongly for modifications in the proposals to minimize these effects.

A major question mark is the application of the large increase in federal tax revenues that will occur from the White Paper proposals by the fifth year of enactment. This increase has been variously estimated to amount to between \$800-1,500 million or more in the fifth year of the new system. In the private sector a large part of these resources would undoubtedly have been saved and invested. There is no way of knowing whether they will be used by the government for capital purposes or spent on current programs. Consequently, until more information is available from the government regarding plans for spending this additional revenue, many Canadians must be very skeptical about the appropriateness of such a transfer. The Association believes that a transfer of this amount from the private to the public sector runs a real risk of inhibiting the rate of growth in the economy.

The persistently wide gap that has existed and appears likely to continue to exist in the private sector between the demand for capital funds and the supply of domestic savings stresses the need for a program to stimulate a larger volume of personal saving. This conclusion is strengthened in the Association's view by the declining proportion that contractual saving,⁽¹¹⁾ the

(11) Excluding the Canada and Quebec Pension Plans.

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most stable element of personal saving, is contributing to total personal saving. Many countries interested in maintaining or increasing the contractual proportion of their personal savings flow have accorded preferred tax treatment to life insurance premiums. The Association recommends that serious consideration be given to extending some form of preferred tax status to the premiums paid by Canadian policyholders.

In addition, the Association suggests there is a need to introduce a more broadly based savings-incentive scheme. An early step should be detailed examination of such programs in countries whose basic economic and socio-political structures are like our own. While none of these programs is likely to be completely applicable to Canada's specific problem, it is expected that useful ideas would emerge.

Specifically, any savings-incentive program should meet the following criteria:

1. It should promote saving without seriously cutting revenue.
2. It should promote truly new savings, not merely shift existing flows.
3. It should not violate the concepts of equity and progressivity embodied in the tax reform proposals.

In order to meet these criteria such a program would have the following characteristics:

1. It would attempt to make savers of non-savers, thus yielding real increases in savings rather than subsidizing existing flows.
2. It would apply to as wide a range of savings media as possible, thus minimizing the "shift" effect.
3. It would be in the form of a tax credit (or exemption or rebate) on new savings flows rather than on income from existing savings.

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Taken together the characteristics imply some program designed to appeal to and benefit lower-income Canadians. Such a program would seem to be generally consistent with the aims of the tax reform proposals. The present registered retirement plan is the prototype of such a system and could be liberalized to increase the savings yield. However, there would be merit in supplementing registered plans by a scheme in which more savings media could be used for shorter durations and for broader purposes. Higher education and better housing are two obvious goals for savers in such a scheme.

The general approach would allow a tax credit of x dollars for every y dollars of income diverted into an acceptable savings instrument up to some maximum. As an example, a one dollar tax credit might be given for every two or three dollars of savings. As to acceptable instruments, any of a wide range of deposits or contractual savings plans of intermediary institutions in Canada should qualify with the proviso that the asset be frozen for at least five years. A savings limit of \$500 a year per taxpayer might be reasonable. A flat 25% withholding tax on the proceeds of an acceptable instrument might be levied when they are realized.

If any such approach were adopted, research would be needed to establish the level of tax credit which would produce the optimal result. If the credit were set as indicated, the results in newly-generated saving could be significant.

Table 1

AGGREGATE DOMESTIC SAVINGS AS PERCENT OF GROSS NATIONAL EXPENDITURE

Saving	Persons and Unincorporated Business		Corporate & Government Business Enterprises		Inventory Valuation Adjustment	Government Saving Gross(Net)	Residual	Total Domestic Saving
	(1)	Depreciation	Profits(2)	Depreciation				
1950	4.4	4.7	4.4	5.1	-2.1	5.9 (3.1)	0.2	22.6
1951	6.3	4.7	3.6	5.0	-3.1	6.9 (3.9)	-0.4	23.0
1952	5.7	4.5	3.1	4.9	0.5	3.8 (0.2)	0.8	23.3
1953	4.9	4.7	3.6	5.4	0	3.3 (0.3)	0.9	22.8
1954	1.8	5.1	3.1	6.2	0.3	2.4(-1.1)	0.3	19.2
1955	2.3	5.2	4.6	6.3	-0.7	3.3(-0.1)	0.4	21.4.
1956	3.1	5.0	4.7	6.6	-0.8	4.5 (0.9)	0.6	23.7
1957	2.9	4.9	3.7	7.3	-0.2	3.9(-0.1)	0.1	22.6
1958	3.3	4.8	3.9	6.8	-0.1	1.0(-3.2)	0.6	20.3
1959	2.4	4.8	4.2	7.1	-0.3	2.7(-1.7)	0.1	21.0
1960	2.4	4.9	3.8	7.2	-0.1	2.2(-1.8)	0	20.5
1961	2.1	4.8	3.7	7.1	-0.1	1.8(-2.5)	0	19.4
1962	3.7	4.7	4.2	7.2	-0.3	2.5(-2.0)	-0.8	21.2
1963	4.1	4.6	4.4	7.1	-0.4	2.6(-1.7)	-0.7	21.8
1964	3.0	4.5	5.3	6.8	-0.3	4.0 (0)	-0.4	23.0
1965	4.0	4.4	5.3	6.6	-0.6	5.0 (0.6)	-0.3	24.5
1966	5.1	4.2	4.6	6.4	-0.5	5.5 (0.8)	-0.1	25.2
1967	4.9	4.1	4.2	6.5	-0.5	5.2 (0.5)	-0.6	23.9
1968	4.6	4.0	4.2	6.3	-0.4	5.8 (1.3)	-0.8	23.7
1950-68	3.7	4.7	4.1	6.4	-0.5	3.8(-0.1)	0	22.2

(1) Includes adjustment on grain transactions.

(2) Includes capital assistance.

Sources: D.B.S. 13-201, National Income and Expenditure Accounts 1926-68
 Unpublished D.B.S. data.

Table 2
CREDIT FLOWS IN CANADA, 1965-1970

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	1965	1966	1967	1968	1969	(estimate) 1970
(millions of dollars)						
DEMAND FOR NEW FUNDS = USES (includes Canadian borrowing abroad)						
Long-term funds						
Mortgages	2361	1969	1906	2109	2175	2350
Corporate finance						
Bonds	1093	1025	1017	621	750	875
Stocks	240	461	268	932	650	950
Sub-total: Corporate finance	1333	1486	1285	1553	1400	1825
Government bonds (direct & guaranteed)						
Federal	-71	380	638	1017	287	450
Provincial	748	1615	1848	1817	1800	2200
Municipal	295	511	655	409	425	400
Sub-total: Government bonds	972	2536	3141	3243	2512	3050
Foreign securities	60	351	374	459	50	100
<u>Total: Long-term funds</u>	4726	6312	6706	7364	6137	7325
Short-term funds						
Money-market paper						
Government of Canada treasury bills	10	20	285	370	70	150
Finance company and other short-term commercial paper	-126	224	103	582	750	700
Sub-total: Money-market	-116	224	388	952	820	850
Bank loans	1478	663	1262	1076	1200	1200
Other loans	623	724	965	642	1250	900
Trade receivables	1882	1200	862	1332	1400	1250
Consumer credit	826	611	840	1204	1350	1250
<u>Total: Short-term funds</u>	4693	3412	4317	5206	6020	5450
<u>Total: Satisfied demand</u>	9419	9724	11023	12570	12157	12775
SUPPLY OF NEW FUNDS = SOURCES (includes Canadian lending abroad)						
Non-bank financial institutions						
Life insurance companies, incl. pension funds	632	635	693	704	635	690
Trusted pension funds, excl. life insce. co's.	432	480	509	745	650	705
Canada and Quebec pension plans	----	642	895	948	1050	1100
Fire and casualty insurance companies	137	242	179	186	210	225
Contractual-savings sector	1201	1999	2276	2583	2515	2720
Trust companies, excluding pension and other fiduciary business	555	387	318	518	650	685
Credit unions and caisses populaires	304	293	503	309	200	225
Quebec savings banks	32	26	26	43	45	40
Non-bank deposit institutions	891	706	817	870	895	950
Open-end mutual funds	334	300	146	298	225	275
Mortgage-loan companies	334	118	161	166	260	275
Sales finance and consumer loan companies	529	101	200	459	500	450
Investment dealers	-93	139	65	85	300	100
Other non-bank financial institutions	397	6	25	267	100	100
<u>Total: Non-bank financial institutions</u>	3593	3369	3720	4728	4825	4870
Chartered banks	1874	961	2710	3059	1850	2300
Bank of Canada	355	6	322	134	140	150
Non-financial business corporations	2182	1300	1089	1400	1175	1200
Government entities						
Provincial and municipal governments	519	809	675	965	950	1000
Federal government	-118	557	163	331	130	250
Non-financial government enterprises, provincial and municipal	34	110	-3	41	100	100
Non-financial government enterprises, federal	31	-23	-92	243	100	----
Federal public financial institutions**	587	966	1083	757	825	1000
(Of which: CMHC)	(280)	(470)	(680)	(400)	(525)	(600)
<u>Total: Government entities</u>	1053	2319	1826	1851	2105	2350
<u>Total: Domestic institutional sources</u>	9,057	7,955	9,667	11,172	10,095	10,870
Foreign portfolio investment in Canada	422	746	1091	1448	1950	1250
<u>Total: Foregoing sources</u>	9,479	8,701	10,758	12,620	12,045	12,120
RESIDUAL: Persons and unincorporated business	-60	1083	265	-50	112	655
<u>Total: Utilised Supply</u>	9419	9724	11,023	12,570	12,157	12,775

Table 3

PERSONAL SAVING AS PERCENT OF NET PRIVATE SAVING

	<u>GNP</u>	<u>Personal Saving</u>	<u>Net Private Saving</u>	<u>Contractual Saving Excluding CPP and OPP</u>	<u>Personal Saving as ratio of Net Private Saving</u>	<u>Contractual Saving as ratio of Personal Saving Excluding CPP and OPP</u>
1962	42,353	1,565	3,183	993	49.2%	63.5%
1963	45,465	1,749	3,585	1,110	48.8	63.5
1964	49,783	1,379	3,799	1,265	36.3	91.7
1965	54,897	2,249	4,925	1,201	45.7	53.4
1966	61,421	2,999	5,623	1,357	53.3	45.2
1967	65,608	3,295	5,783	1,381	57.0	41.2
1968	71,454	3,516	6,173	1,635	57.0	46.5
Annual Growth Rate	9.1%	14.4%	11.7%	8.8%		

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Table 4

DISPOSITION OF NATIONAL SAVINGS AS PERCENT OF GROSS NATIONAL EXPENDITURE

	<u>Business Gross Fixed Capital Formation</u>		<u>Physical Change in Inventories</u>	<u>Government Investment</u>	<u>Total Domestic Investment</u>	<u>Residual</u>	<u>Current Account Balance</u>
	<u>Nonresidential Construction Plus Machinery and Equipment</u>	<u>Residential Construction</u>					
1950	13.3	5.3	3.0	2.9	24.3	-0.2	-1.7
1951	14.0	4.0	4.1	3.0	25.5	0.4	-2.5
1952	14.0	3.9	2.2	3.2	22.5	-0.8	0.8
1953	14.6	4.9	2.8	3.1	24.5	-0.9	-1.7
1954	13.6	5.6	-1.6	3.5	20.8	-0.3	-1.6
1955	13.2	6.4	1.1	3.4	23.7	-0.4	-2.3
1956	16.0	5.8	3.2	3.6	28.0	-0.6	-4.3
1957	17.3	5.1	0.6	4.0	26.9	-0.1	-4.3
1958	14.8	6.1	-0.9	4.1	23.5	-0.6	-3.2
1959	13.8	5.9	1.1	4.2	24.9	-0.1	-3.9
1960	13.6	4.7	1.1	4.1	23.5	0	-3.0
1961	12.4	4.6	0.3	4.3	21.6	0	-2.2
1962	12.0	4.4	1.3	4.5	23.0	0.8	-1.8
1963	12.3	4.3	1.3	4.4	22.9	0.7	-1.1
1964	13.6	4.8	0.9	4.1	23.8	0.4	-0.8
1965	14.9	4.8	2.1	4.5	26.6	0.3	-2.1
1966	16.2	4.2	2.0	4.6	27.2	0.1	-2.0
1967	14.7	4.3	0.6	4.6	24.9	0.6	-1.0
1968	13.3	4.6	1.0	4.5	24.2	0.8	-0.5
1950-68	14.1	4.9	1.4	3.9	24.3	0	-2.1

Sources: Same as Table 1

Table 5

PRIVATE AND PUBLIC INVESTMENT EXPENDITURES
(excluding non-farm inventories)

	1956	1958	1960	1962	1964	1966	1968	(est)
<u>Private Business Enterprises</u>	4,165	3,713	4,029	4,166	5,459	7,773	7,365	7,966
<u>Private Non-Business</u>	160	230	236	291	333	415	418	480
<u>Institutions</u>	1,519	1,712	1,428	1,566	2,014	2,153	2,821	3,175
<u>Housing</u>	1,679	1,972	1,664	1,857	2,317	2,568	3,239	3,655
<u>Public</u>	909	1,237	931	870	1,226	2,006	1,967	2,125
<u>Government-owned enterprises</u>	269	324	365	564	152	818	1,020	1,065
<u>Gov't oper. Instit. & Housing</u>	1,012	1,118	1,274	1,258	1,160	1,925	2,087	2,233
<u>Government departments</u>	2,190	2,679	2,569	2,692	3,136	4,742	5,074	5,423
<u>Sub-Total</u>	8,034	8,364	8,262	8,715	10,944	15,090	15,678	17,046
<u>Total</u>	51.8	44.4	48.8	47.8	49.9	51.5	47.0	46.7
<u>As % of Total</u>	20.9	23.6	20.1	21.3	21.4	17.0	20.7	21.4
<u>Private business enterprises</u>	27.3	32.0	31.1	20.9	28.7	31.5	32.4	31.8
<u>Public</u>	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0
<u>As % of GNE</u>	13.3	10.9	10.7	9.8	11.0	12.7	10.3	10.2
<u>Private business enterprises</u>	5.4	5.8	4.4	4.4	4.7	4.2	4.5	4.7
<u>Private non-business</u>	7.0	7.9	6.8	6.4	6.3	7.7	7.1	6.2
<u>Public</u>	25.6	24.5	21.9	20.6	22.0	24.6	21.9	21.8
<u>Total¹</u>								

1. as in 'national saving account-disposition' but including government fixed capital formation

Source: D.B.S. and Dept. of Trade & Commerce, Private and Public Investment in Canada, annual
D.B.S. National Income and Expenditure Accounts

APPENDIX "E"

INSURANCE BUREAU OF CANADA

LEGAL DIVISION

170 UNIVERSITY AVENUE, TORONTO 1 ONT.
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INSURANCE BUREAU OF CANADA

SUBMISSION ON THE PROPOSALS FOR TAX REFORM
CONTAINED IN THE WHITE PAPER DATED NOVEMBER 7, 1969

March 16, 1970

INTRODUCTION

The Insurance Bureau of Canada is an organization of the major insurers in the Canadian market to provide a channel of communication between the fire and casualty insurance industry and Governmental and other bodies with whom communication may be necessary. The membership of the Insurance Bureau of Canada includes two presently existing associations of long standing and a number of independent companies. Including the members of those associations, the total company membership is 193 and its members wrote total premiums in excess of \$1,257,000,000 in 1968. This represents approximately 85% of the total premium income in Canada for those classes of insurance which are of interest and concern to the Insurance Bureau of Canada.

This submission confines itself to those particular spheres which are of common interest and concern to all insurers. It will be recognized that some members of the Bureau, such as British and foreign insurance companies, may have special representations to make which are not of common interest and concern. Such representations, if made, will be made by those particularly affected.

For purposes of ready reference, whenever a particular paragraph of the White Paper is referred to, it will be indicated as follows: "W.P. 2.11". Where reference is made to the Report of the Royal Commission on Taxation, a similar system is used, the reference being indicated by "R.C.T. 547(a)" - the reference is to the CCH publication on that report.

PART I
GENERAL

In this part of the submission comment is confined to the general implications of the proposals as they affect Canada; the other parts of the submission concern matters which directly affect the fire and casualty insurance industry and industries which are peripheral to that industry.

The government has stated that the goals and standards that have guided the government in its approach to tax reform include:

1. a fair distribution of the tax burden based upon ability to pay
2. steady economic growth and continuing prosperity
3. the recognition of modern social needs
4. widespread understanding of and voluntary compliance with tax laws
5. a system that can and will be used by the provinces as well as Canada.

These motives cannot be questioned, although underlying any present or proposed tax system lies the primary purpose of taxation, namely raising money to meet expenditures of government.

It should be stated at the outset that failure to comment on certain provisions of the White Paper does not mean that the Insurance Bureau of Canada necessarily accepts them. This is particularly true of taxing capital gains, both realized and unrealized. Canada, being a developing country, needs risk capital and a tax on capital gains could well stifle growth. However, on the assumption that the government has accepted the concept of taxing capital gains, comments have been made after taking into account this assumption.

A number of the proposals in the White Paper meet the stated objectives and it is understandable that there are areas which, due to their complexity, are in need of clarification or minor alteration.

There are however certain major proposals with which issue is taken, namely:

1. Taxation on unrealized gains of shares (W. P. 3.33).
2. The increase in rates levied on skilled individuals whose incomes are generally over \$10,000 a year (W. P. 2.30 and Tables 5 and 6).

1. UNREALIZED GAINS

Exception is taken to the taxation of unrealized gains every five years, or when an individual ceases to reside in Canada, for the following reasons:

(a) A major shareholder of a widely-held corporation may be required to dispose of a substantial portion of his interest in the corporation to meet the tax liability. Since many large Canadian owned corporations fit this situation, a gradual erosion of Canadian ownership of large corporations can be foreseen as it is highly probable that certain of the shares so disposed will be acquired by foreign interests.

This conclusion is reached for two reasons. Firstly, it is often preferable to dispose of a block of shares privately to another individual or corporation rather than endeavour to "unload" these shares on to the open market. The private trade could well be with a non-resident. Secondly, if the participation of non-resident investors in Canadian shares on the open market is as active as it is at present, certain shares released on to the open market by Canadians settling tax liabilities are bound to be acquired by non-residents.

(b) An unnatural situation will occur whereby stock market fluctuations will depend upon such events as the fifth anniversaries of major shareholders of widely-held corporations.

(c) Taxation appears to be proposed for unrealized gains obtained by non-residents where they control over 25% of a widely-held corporation (W. P. 3.33 and 6.47). Here the concept runs contrary to most tax treaties and difficulty may be experienced by the government on this point in renegotiating their tax treaties.

(d) Neither the United States of America nor the United Kingdom levy a tax

on unrealized gains, with the minor exception that revaluation occurs in trusts in the United Kingdom every fifteen years with resultant tax on any gain.

In view of these points, it appears that the objectives of the government on tax reform will not be met. If the government finds that the "lock in" effect of not taxing unrealized gains is repugnant, perhaps a combination of estate taxes and income taxes could be achieved whereby realizations are deemed to occur on death. This solution has been raised in the United States in considering tax reform. This suggestion is made only tentatively and would require substantial research.

On balance, it is recommended that taxation not be levied on unrealized gains of shares in widely-held corporations as estate taxes presently impose a tax on the accumulation of wealth.

2. INCREASE IN RATES

Canada, the United States of America and various other countries, in an advanced state of technology, are actively competing for professional and managerial skills on the world labour market. Under the present rate structure, individuals earning over \$10,000 are taxed more heavily than in the United States. Under the proposals, the difference in tax rates becomes even more significant. It is stated in the White Paper that increases in rates "do not seem large enough to change behaviour patterns in any marked degree" (W.P. 8.37) and that secondly "changes in conditions in the U.S. seem to have made that country less attractive to Canadians considering emigration and changes in its immigration laws have made it more difficult for Canadians to emigrate to the U.S." (W.P. 8.38). Surely it is not intended that Canadians of skill and ability be put into a cage for, if true, it would be sufficient indictment of the proposed system to call for its immediate abandonment. In addition

Canada should not be placed at a disadvantage in obtaining skilled immigrants who because of tax rates might choose to settle in countries other than Canada.

Clarification is sought on the studies carried out by the government which lead it to reach these conclusions and if these studies are found to be inadequate, it is recommended that further research be made to determine whether increases in rates will lead to a significant loss of skills to Canada. It is further recommended that any comparison which is made between the taxes paid by residents of the United States and those of Canada should take into account the many special deductions which are available to U.S. residents.

PART II

FIRE AND CASUALTY INSURERS

Prior to any commentary on the White Paper on Tax Reform, a brief summary of the nature of the operations of fire and casualty insurers is needed, in order that the impact of the White Paper can be gauged.

Fire and casualty insurers underwrite risks in Canada in return for a premium. The term of the policies covering the risk can be for a period ranging from one to three years. Since the whole purpose of insurance is to spread risk, insurers in Canada invariably reinsure among themselves and with insurers outside Canada. Indeed reinsurance placed outside Canada represents an important feature of underwriting in Canada since large risks cannot be carried to any great extent by domestic insurers.

Conversely, a number of Canadian insurers carry on business outside Canada or assume risks situated outside Canada by way of reinsurance. These risks may then be reinsured in part in Canada or outside Canada. It can be seen therefore that fire and casualty insurance and reinsurance is fluid and international in character.

The prime concern of governments has been the protection of policyholders situated in their jurisdiction. To this end, governments in Canada, both federal and provincial, in the United States of America and in other countries have devised laws and regulations whereby insurers must maintain assets in the country of the risk at least equivalent to the liabilities of the insurer notwithstanding that the actual liabilities are reduced by reinsurance placed outside the national boundary. These assets must be reasonably liquid which in effect means that substantial portfolios of readily marketable securities are held by insurers in countries in which

they do business. In addition, to maintain the solvency of insurers restrictions are often placed by governments on the distribution of surplus to the shareholders of insurers by way of dividends.

Finally the accounting terminology of the general insurance business has led to a great deal of misunderstanding on the part of people outside the industry.

It is unfortunate for example that the term "reserve" is used in the insurance industry. In fact these so called "reserves" are liabilities for claims, or premiums received in advance, for policies which are in force.

1. LOSSES

No mention is made in the White Paper of any changes in the treatment of business loss carry overs. Presumably therefore it is the intention of the government that the present rules remain in force, namely that business losses may be applied against income, back one year and forward five. This treatment is contrary to that recommended in The Report of the Royal Commission on Taxation which states, "we recommend that the period be extended to permit losses to be carried back two years and carried forward indefinitely". (R. C. T. 547(a)).

Due to the nature of insurance, the profits or losses derived from insurance are not readily determined within one year. Indeed the earnings of insurers appear to move in cycles of between five to ten years.

Consequently the present treatment of losses is proving inadequate for these taxpayers. A real danger exists in the event of a catastrophe in Canada where insurers would suffer substantial losses without being able to recoup the taxes that they had paid in profitable years before the catastrophe. It is therefore recommended that losses be carried back five years and forward ten years. It should be noted

however that the Royal Commission on Taxation recommended that losses be carried forward to extinction.

2. ENTERTAINMENT AND RELATED EXPENSES

(a) Disallowance of entertainment and related expenses

The government proposes that certain expenses, such as entertainment, convention and social and recreational club expenses, not be allowed as deductible expenses. The White Paper indicates that, although such expenses may be proper business expenses, taxpayers who incur them, must do so out of tax-paid income (W.P. 2.11, 5.9 - 5.10).

While the provisions regarding deductibility of entertainment expense in the United Kingdom appear to be abnormally restrictive, practices followed in the United States merit consideration. Here, the taxation authorities in the United States have set guidelines for the deduction of entertainment expenses which appear to be reasonable. Generally those expenses which are "lavish or extravagant" are not deductible and record keeping is stringent with regard to deductible expenses. If the government is determined to amend the present provisions for entertainment expenses it should seek only to exclude as deductions those expenses that are "lavish or extravagant" and reference can be made to the very detailed and comprehensive regulations existing in the United States which govern entertainment expenses.

While it is conceded that certain entertainment and related expenses, such as the maintenance of yachts and resorts, merit disallowance as deductions, it seems to be the government's attitude that businessmen are getting undue benefit for what is called "expense account living" (W.P. 2.11). Employees of insurance companies and independent agents and adjusters are obliged by the nature of their work to

spend a considerable amount of time, away from home, visiting policyholders, examining claims, overseeing branches and attending seminars. This work naturally involves the outlay of what are called "entertainment expenses". These expenses are a very poor substitute for staying at home but are necessary if employees and agents are to meet people on an informal basis to discuss business and to carry out their work.

Therefore it is submitted that the government proposals are in error in their apparent assumption that virtually no business benefits are to be gained by these expenditures and that they necessarily constitute "expense account living". Indeed the White Paper exaggerates the concept of "expense account living". To the extent that such expenditures are not found to be reasonable, the existing legislation is more than adequate to disallow them

(b) Non-creditable tax

The White Paper further provides that, in order to ensure that the additional tax paid by corporations, as a result of the disallowance of entertainment expenses, is not recovered by a tax credit given to shareholders in respect of a subsequent dividend, such tax would not be creditable to shareholders (W. P. 5.10). It is submitted that such a provision would be counter-productive having regard to the business reasons for the incurring of such expenditures and therefore would raise very considerable problems of compliance and administration.

3. CORPORATE STRUCTURE

Most fire and casualty insurers operate either as Canadian companies or branches of non-resident companies. From a taxation standpoint, branches of non-resident companies are presently treated in very much the same way as Canadian

companies. Without belabouring some very technical sections of the Income Tax Act, it is sufficient to point out that the Canadian branch of a non-resident is required to set up a Canadian Investment Fund from which all income is taxed as if the branch were a Canadian company. The Canadian Investment Fund approximates the fund that an equivalent Canadian company would need to transact insurance in Canada. Withdrawals from the fund are taxed in much the same way that dividends paid to non-resident shareholders suffer a withholding tax. Income derived from investments outside the Canadian Investment Fund is distinct from that generated by the fund itself and is taxed at normal withholding tax rates. This concept was introduced by the government in 1969 and is intended to be a fair and equitable way of taxing the Canadian branches of non-resident companies.

A problem arises under the White Paper however as to the manner in which the Canadian branches of non-resident companies are to be treated for tax purposes. No mention is made as to the treatment of the business and investment income of these branches. It will be noted that the investments in Canada of the branches are substantial due to the requirements of insurance law and regulation.

Clarification is therefore sought as to the status under the White Paper of the Canadian branches of non-resident insurers and adequate comment cannot be made in this regard at this time.

4. TREATMENT OF CAPITAL GAINS

As has been stated at the commencement of this submission, the Insurance Bureau of Canada takes particular issue with the proposal that unrealized capital gains be taxed. Comments in this context are therefore confined to the

taxation of realized capital gains. Under the proposals shareholders of insurance companies, be they closely or widely held companies, will be placed at a disadvantage in respect to capital gains realized by the insurance companies on shares in widely-held corporations. This disadvantage is illustrated in Appendix "A" (Taxation of capital gains from shares in widely-held corporations). It should be noted that by virtue of the various insurance acts, an insurer in Canada wishing to invest in shares, is generally confined to shares in widely-held corporations. (Section 63, Canadian and British Insurance Companies Act).

It is difficult to believe that it is the government's intention to penalize taxpayers who choose to invest in widely-held corporations through the medium of a company, rather than through a mutual fund or directly. Consequently it is recommended that this disparity be eliminated and that investors be treated on an equal basis for tax purposes.

Finally, some measure of relief was indicated, subsequent to the issuance of the White Paper, in regard to the application of capital gains tax to bonds and mortgages. Here the recovery of cost or amortized cost on bonds and mortgages purchased between November 7, 1969, and valuation day would not be taxed. It is difficult to see why this modification should not extend to preferred shares since these securities are, like bonds and mortgages, of a fixed-interest nature.

5. FOREIGN SOURCE INCOME

Some Canadian insurers maintain subsidiary companies or branches in foreign countries. These foreign subsidiaries or branches are normally required

to maintain substantial investments in those countries for the protection of the policyholders resident there. Since most Canadian insurers are closely-held, a review has been made (see Appendix "B") of the tax effect on foreign source income as outlined in the White Paper.

This review discloses that there is a marked disparity of tax incidence depending upon the source of the foreign income as it passes from the foreign country to the Canadian corporation and thence to the Canadian shareholder. There appears to be no compelling reason for this disparity and it is therefore recommended that income from a foreign country from whatever source be treated in the same way for tax purposes.

6. CONSOLIDATED TAX RETURNS

The government proposes to broaden the tax base and the process of flowing income through related persons can be seen in the proposals of the White Paper. Despite these facts, the government appears to have rejected the concept of consolidated tax returns for affiliated companies.

The Royal Commission on Taxation suggested that some form of consolidation for tax purposes should be permitted for groups of corporations under the same ownership (R. C. T. 547(b)). United States law allows consolidated returns to be filed for a parent company and those of its subsidiaries in which it owns 80% or more of the equity capital. The United Kingdom allows profitable and unprofitable companies in an affiliated group to offset their profits and losses. In addition, businessmen and accountants have long recognized that a true reflection of income can only be obtained by consolidating the accounts of affiliated companies.

The rejection of consolidated returns by the government cannot therefore be on logical grounds and one can only conclude that there is some other reason, presently unknown, which leads to this rejection.

Insurers in Canada generally operate in groups of affiliated companies and some companies in a group may specialize in certain specific lines of insurance. Because of the uncertainty of profits and losses experienced by individual companies, the incidence of profits and losses has, to say the least, been uneven. Insurance means spreading the risk and the risk should be spread by area, by company and by line of insurance. It is apparent that losses suffered, for example, on automobile lines should offset the taxable income on other lines and indeed the taxable income of affiliated companies. The denial of consolidated returns is therefore a contradiction of logic, good business practice and bears particularly hard on insurers.

It is true that a degree of consolidation has been proposed for closely-held corporations who make a partnership election. This proposal however has very limited effect, since it is restricted to corporations which are closely-held, have only one class of shares, whose affiliates all have the same fiscal year, whose shareholders all reside in Canada and have signed a partnership election.

It is recommended that consolidated returns be allowed for tax purposes for all types of business entities.

7. DIVIDENDS

The payment of dividends by Canadian insurance companies is restricted by law (Sections 103, 104 and 105, Canadian and British Insurance Companies Act). Generally speaking, an asset ratio to liabilities must be maintained and dividends are often restricted to an amount which cannot exceed 75% of the average annual profits of the company for the three preceding calendar years.

Under the proposals of the White Paper, tax paid by a closely-held or a widely-held corporation with respect to a given taxation year will be creditable to

the shareholders only if it is passed through to the shareholders within 2 1/2 years from the end of the corporation's taxation year (W. P. 4.27).

It is obvious that the provisions of insurance law and the proposals of the White Paper are in conflict and should be reconciled. Under the proposals, shareholders of insurance corporations are bound to lose creditable tax due to the 2 1/2 year limitation and the 75% distribution rule. It is therefore suggested that the insurance acts might be amended to allow for the distribution of dividends by way of stock notwithstanding the formulae used in determining allowable cash dividends.

8. AMALGAMATIONS

Under present income tax law, Canadian corporations may under certain conditions amalgamate without imposition of tax on a deemed distribution of surplus (Income Tax Act S. 851). Under the proposals of the White Paper the existing situation will be maintained providing there is no change of economic interest and if the amalgamations involve widely-held corporations (W. P. 3.49-3.52). The proposals concede that "it may be possible later to identify more situations in which a rollover can be granted"

It is most important that, in an industry such as insurance, companies and branches under the same ownership be allowed to amalgamate without imposition of tax. The present tax law penalizes the Canadian domestication of foreign branches of insurers (S. 110B - Income Tax Act) and the proposals of the White Paper would appear to extend this penalty to amalgamations of closely-held insurance corporations; both situations applying even where no dividend or benefit has been passed on to the shareholders.

It is recommended that the present tax concept remain that mergers or amalgamations do not give rise to tax unless a benefit has been given to the owners

or shareholders by means of the merger and that this concept should cover all business entities operating in Canada, be they foreign branches or corporations, widely or closely-held.

PART III

PERSONS CONNECTED WITH FIRE AND CASUALTY INSURERS

Certain proposals in the White Paper, although they affect persons other than insurers, have a bearing upon insurers. These proposals relate to insurance agents, insurance adjusters, personnel of insurance companies and the holders of insurance policies.

1. THE INSURED

(a) Forced realizations

The government proposes to exempt from taxable income the proceeds from forced realizations, such as proceeds from claims under an insurance policy, if the taxpayer uses these proceeds to purchase replacement property within one year of the receipt of the proceeds. (W.P. 3.44).

While it is conceded that some time limit must be placed upon such realizations, the term of one year seems too stringent. In many instances an insured, having received proceeds on a claim, would be unable to replace the asset destroyed, damaged or stolen within a period of one year, particularly where the original asset was of a complex nature. It is recommended that the time limit be extended to at least two years.

(b) Losses on personal property

While it should be noted that the Insurance Bureau of Canada finds the taxation of gains on disposal of personal property to be objectionable in principle, the proposed treatment of losses of personal property, such as paintings, jewellery and antique furniture, requires comment (W.P. 3.22 - 3.26). It is stated in the White Paper that such losses may only be applied against gains of the same nature, either in the immediately preceding or following year. It must be borne in mind that a

taxpayer who trades in these assets is taxed under the present tax system and therefore these proposals affect only taxpayers who hold personal property for non-business reasons. It is difficult to imagine a situation where such a taxpayer would ever be able to benefit from application of such losses which in many cases would occur through being underinsured on a risk such as fire or burglary. It is recommended that losses of this nature which might be described as "casualty losses" be available for application against other income in the appropriate year.

(c) Insurance premiums

Commentators on the White Paper have intimated that insurance premiums might be added to the cost basis of assets. It is recommended that, in any event, insurance premiums should continue to be regarded as normal business expenses treated in the same way as such items as repairs and maintenance.

2. PERSONNEL OF INSURANCE COMPANIES

(a) Entering and leaving Canada

The White Paper proposes capital gains treatment on deemed realizations of all assets of an individual on the day he gives up his Canadian residence, regardless of whether the move is of a temporary or permanent nature. (W.P. 3.40). Furthermore, every taxpayer taking up residence in Canada would be required to value his world-wide assets with effect from the day he came to Canada at their full market value for capital gains purposes.

The insurance industry is international in character and its employees frequently move from one country to another to gain skill and experience. The proposals would provide a strong disincentive to the temporary assignment of personnel inside and outside Canada. Any tax system which would expose Canadians to a tax on unrealized gains upon giving up Canadian residence places an impossibly high premium on the gaining of international experience.

There are additional problems connected with this proposal. The most obvious problem is that of compliance in valuing fairly the assets, wherever situated in the world, of an individual when he leaves or arrives in Canada. Further, the proposed treatment bears particularly hard upon temporary residents from the United States of America and the United Kingdom. Here, deemed or actual realizations of shares of United States or United Kingdom public companies held by such individuals would have to be included in full in Canadian taxable income. A former resident of the United Kingdom or of the United States would have difficulty in converting investments into Canadian widely-held corporations, thereby losing the related tax advantages, due to exchange controls in the United Kingdom or the Interest Equalization Tax in the United States. In addition, a citizen of the United States, who remains liable for United States taxes on realized capital gains, may not be able to claim credit against these taxes for Canadian taxes levied on deemed realizations arising out of five-year revaluations or revaluations upon leaving Canada.

The whole matter must be viewed with the basic proposition that taxes should not be levied on unrealized gains. Consequently tax should only become exigible on the realization of assets while the individual is resident in Canada.

While it is agreed that individuals residing in Canada should be taxed on an equitable basis, some distinction should be made between those who intend to "put down roots" in Canada and those who are in Canada on a temporary basis only. A question arises as to how long is "temporary." Immigration requirements presently exist whereby an individual may only become a Canadian citizen after being in Canada for a period of five years and during this twilight period his or her rights are somewhat restricted. It is suggested therefore that "temporary" mean any period under five years.

It is recommended therefore that on entry into Canada an individual value only those assets that are Canadian assets and securities (or rights to securities) in the company (or its associates) of which the individual is an employee or officer. During the period that the individual is in Canada, up to a period of five years, he should be taxed upon his world-wide income with the major exception of realized gains on assets which were not valued on entry into Canada. If the individual remains in Canada, on the fifth anniversary of his entry into Canada, all assets would be valued and tax levied on any subsequent realized gain on world-wide assets. If an individual returns to Canada the moratorium period of five years would only apply if the individual had resided outside Canada for at least five years.

These recommendations should allow for relatively easy movement of employees on an international basis without altering the basic tenets of the White Paper.

(b) Tax treaties

It is strongly recommended that in negotiating tax treaties the government ensure that due credit is given to residents of Canada for taxes levied in foreign countries, having in mind the capital gains taxes presently existing in the United States and United Kingdom.

3. INDEPENDENT INSURANCE AGENTS AND ADJUSTERS

(a) Opening work-in-process and accounts receivable

Many individuals are regarded as professionals for tax purposes and therefore have been allowed to use the cash basis of computing profits as provided in Section 85F of the Income Tax Act. The White Paper considers that the postponement of tax by the professional using the cash basis gives him an unwarranted advantage over other taxpayers. The Government therefore proposes

that the professional be required to compute his income on an accrual basis (W.P. 5.46 5.47).

In the first year of the new system, the taxpayer will be permitted to include the values of his opening accounts receivable and inventory which will not have previously been taxed. During the first and subsequent years under the new system, whenever the value of the opening accounts receivable and inventory is greater than the closing value of these assets, the excess will be added to the income calculated on the accrual basis until the full amount of the opening untaxed accounts receivable and inventory has been taxed.

Under the present Income Tax Act there is some doubt that the agent's or the adjuster's work-in-process would qualify as inventory and in addition this inventory would have to be valued at cost, market or the lower of cost or market although these terms are not defined. It might therefore be preferable to exclude work-in-process from inventory unless a satisfactory definition can be incorporated into the new legislation. Indeed there are indications that the government is already contemplating the exclusion of work-in-process.

By bringing into the tax base the accounts receivable and inventory existing at the start of the new proposed system, there is a retroactive effect which is deplored. It is recommended that the individual start under the proposed system with a "clean slate" without bringing into income these opening balances.

(b) Unearned income

It is recommended that only earned income is taxed which in the case of an insurance agent would relate to the portion of his commission which relates to the insurance policy year. In other words, if an agent receives commission on a three-year policy he earns commission over the life of that policy and not in the year in which the policy was written.

APPENDIX "A"

TAXATION OF CAPITAL GAINS FROM SHARES IN
WIDELY-HELD CORPORATIONS

	Recipient of dividend			
	CHC	WHC	Mutual	Direct
	\$	\$	\$	\$
THE CORPORATION				
Gain	<u>120,000</u>	<u>120,000</u>	<u>120,000</u>	<u>120,000</u>
Taxable gain	60,000	120,000	120,000	60,000
Tax thereon	<u>30,000</u>	<u>40,000</u>	<u>40,000</u>	
Available for distribution	<u>90,000</u>	<u>80,000</u>	<u>80,000</u>	
THE SHAREHOLDER				
Gross up distribution	<u>120,000</u>	<u>120,000</u>	<u>120,000</u>	
Tax thereon - 40%	48,000	48,000	24,000	24,000
Less: Tax credit	<u>30,000</u>	<u>40,000</u>	<u>40,000</u>	
Net tax payable (recoverable)	<u>18,000</u>	<u>8,000</u>	<u>(16,000)</u>	<u>24,000</u>
Net return	<u>72,000</u>	<u>72,000</u>	<u>96,000</u>	<u>96,000</u>

KEY:

CHC	-	Closely-held corporation.
WHC	-	Widely-held corporation.
Mutual	-	Mutual Fund.

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	Source of income			
	Non-controlled foreign corp. \$	Controlled foreign corp. - treaty \$	Controlled foreign corp. - non-treaty \$	Foreign branch Tax Haven \$
FOREIGN				
Dividend (or branch income after foreign tax)	1,000	1,000	1,000	1,500
Foreign withholding tax	<u>150</u>	<u>150</u>	<u>150</u>	
CANADA				
Net income received	850	850	850	1,500
Gross up for foreign tax (foreign profits taxed - 33 1/3%)	<u>150</u>	<u>150</u>	<u>650</u>	
Taxable income	<u>1,000</u>	<u>1,000</u>	<u>1,500</u>	<u>1,500</u>
Gross tax	500		750	750
Tax credit	<u>150</u>		<u>650</u>	<u>500</u>
Net Canadian tax	<u>350</u>		<u>100</u>	<u>750</u>
Dividend "declared"	588	1,000	882	750
Less: Foreign creditable tax "deducted"	<u>88</u>	<u>150</u>	<u>132</u>	<u>132</u>
Net cash for dividend	<u>500</u>	<u>850</u>	<u>750</u>	<u>750</u>
INDIVIDUAL				
Net dividend received	500	850	750	750
Gross up - foreign tax (15/85 of net dividend received, limited to foreign creditable tax of payer)		150	132	176
- Canadian tax	<u>88</u>		<u>100</u>	<u>250</u>
	<u>412*</u>			
Gross tax at 40%	<u>1,000</u>	<u>1,000</u>	<u>982</u>	<u>1,500</u>
Tax credit	400	400	393	600
Net tax	<u>500</u>	<u>150</u>	<u>232</u>	<u>750</u>
Net dividend retained	<u>(100)</u>	<u>250</u>	<u>161</u>	<u>(150)</u>
	<u>600</u>	<u>600</u>	<u>589</u>	<u>900</u>

* This amount of gross-up assumes that the paying corporation has other creditable tax on hand.

APPENDIX "F"



Minister of Finance

Ministre des Finances

Ottawa 4,
June 11, 1970.

The Honourable S. A. Hayden,
Chairman,
The Senate Committee on Banking,
Trade and Commerce,
Room 474-F, The Senate,
Ottawa, Canada.

Dear Senator Hayden:

Since the White Paper on Tax Reform was introduced last November, it has been alleged that the government is seeking to obtain a substantial increase in tax revenues under the guise of tax reform. Critics have pointed to the estimate, openly stated in the White Paper, that the proposed system would produce an additional \$630 million in 1969 if that year had been the fifth year of its operation. It has been contended that the hidden purpose is to undertake a major transfer of resources from the private to the public sector, and that this would retard Canadian economic growth.

We are now confronted by a situation in which it is difficult to discuss the nature of the tax reform measures proposed in the White Paper in a logical and dispassionate way because of the emotional climate created by allegations of this nature.

The main reason that the rate schedule in the White Paper would produce more revenue after five years than the present system is simple. It was necessary to implement some of the reforms gradually, and therefore the revenues generated by some of the reforms would be received only

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gradually. At the same time it was necessary to raise approximately the same amount as the present system in the first year in order to cover government expenditures. The phasing-in of some proposals would naturally produce additional revenues in the second, third, fourth and fifth years--and over an even longer period in the case of changes proposed for the resource industries.

The two best examples of the gradual introduction of reforms are the taxation of capital gains and the removal of the low rate of corporate tax. With capital gains, it would be unthinkable to tax people on gains earned over past years even though the proceeds were received in the future. With small corporations, it was thought that they required time to prepare for the change from a rate of 21 per cent to the personal rate of the shareholders.

Since the White Paper was tabled on November 7 of last year I have tried repeatedly to make it clear that tax reform was not intended to produce an increase in tax revenues. I have pointed out many times that as the proposals come fully into effect the additional revenues would make it possible for the government to reduce tax rates. I have also said that the time to focus on the final rate schedules and their net effect on revenues is at the legislative stage when the changes in the White Paper have been made public. But it is clear from the continuing emphasis on this point that I have not succeeded in putting the fears of some taxpayers to rest.

The government has now decided to take a further step to make it crystal clear that its intention with respect to the White Paper is to reform the tax system, not to increase taxes.

The legislation that the government proposes to the House of Commons to implement its tax reform measures will include a fixed schedule of declining income tax rates for each of the first five years of its operation. These schedules will provide for tax cuts in each of the five years designed to ensure that the revenues produced under the new system will not exceed the total that would be produced if the present system remained in effect. The term of five years was selected because it is during that transitional period that most of the proposed tax reform measures would come into effect.

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If the system outlined in the White Paper had been introduced intact in 1969, the procedure we are now proposing would have resulted in tax cuts of about \$630 million by the fifth year. But I have said the White Paper proposals are going to be changed, and the changes will substantially reduce the amount available for prospective tax cuts.

As I indicated at the outset, one of the major criticisms against the White Paper proposals is that the apparent increase in revenue that would take place over a five-year period would reduce the accumulation of savings for private capital investment and retard Canadian economic growth. The undertaking now given by the government to ensure that such a revenue increase does not occur as part of the process of tax reform should allay concern of this nature.

The procedure which I have outlined constitutes an undertaking by the government that the tax reform structure put before Parliament in the form of legislation will be designed to produce the same tax revenues during the first five years as the tax system in effect now.

There will, of course, be a budget each year, and changing economic and social conditions may require changes in tax rates. The establishment of a fixed rate schedule in the tax reform legislation will, however, make it mandatory for this government or any other government to justify any proposed change in rates during the five-year period to Parliament and the people of Canada.

Our undertaking in this letter can only refer to federal taxes. We hope that the provinces will follow our lead but obviously we cannot bind them either to freeze or to reduce their tax rates.

Yours sincerely,



E. J. Benson,
Minister of Finance.

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